State Auditor's Report and Recommendations for the Reform of the Commonwealth's Purchase-of-Service System for its Social and Human Service Programs

Comprehensive Statewide Review of Providers' Indirect Costs Charged to State Contracts

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Office of the State Auditor

A. Joseph DeNucci, Auditor

OFFICIAL AUDIT REPORT

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INTRODUCTION 1

The amount of social services that the state purchases through its purchase-of-service (POS) system has dramatically increased over the past two decades from approximately $25 million in 1971 to approximately $1.6 billion during fiscal year 1993. The increase in state expenditures for purchased services has been attributed to several factors, including a philosophical change in how mentally ill, mentally retarded, and juvenile offenders should be treated; the de-institutionalization of clients residing in state mental health facilities brought about by consent decrees issued in the early 1970s; and the desire of the administration to reduce the size of state government by purchasing, rather than directly providing, these services.

Currently, the Division of Purchased Services (DPS) has responsibility for implementing and coordinating an efficient and accountable system of procurement, selection, pricing, contract administration, program monitoring and evaluation, contract compliance, and post audit for any state agency that procures or pays for social services programs from contracted service providers. Contracted service providers and state agencies that procure POS-related services are required to comply with all applicable DPS regulations and guidelines.

The objectives of our audit were to determine whether contracted human service providers (1) allocated indirect costs to state contracts in a manner consistent with DPS and the federal Office of Management and Budget (OMB) guidelines; (2) developed and implemented an adequate system of internal controls over the authorization, recording, and reporting of indirect costs; and (3) incurred indirect costs that were reasonable, allowable, and allocable to state contracts. In order to meet these objectives, we conducted audits of 18 human service providers, located throughout the Commonwealth, that received contracts from the departments of Mental Retardation (DMR), Mental Health (DMH), Social Services (DSS), Public Welfare (DPW), Public Health (DPH), and Youth Services (DYS); the Massachusetts Commission for the Blind (MCB); and the Massachusetts Rehabilitation Commission (MRC). During fiscal year 1993, the 18 human service providers' revenue totalled $127 million (See Appendix), of which approximately $89 million represented state contracts.

During our audits, we identified 17 deficiencies involving over $6.3 million in state funds. These deficiencies, which were primarily the result of inadequate internal controls within the service providers' contract management systems to monitor service providers, warrant immediate attention and action by the providers and DPS.

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AUDIT RESULTS 4

1. <u>Human Service Providers Utilized State Funds Totalling $454,104 for Purposes Prohibited by DPS Regulations</u>: We found that 11 of the 18 human service providers expended state funds totalling $454,104 on goods and/or services that, according to state regulations, were nonreimbursable under state contracts. The 11 human service providers could avoid similar problems in the future by developing policies and procedures that ensure the proper use of state funds. Presently, several providers need to strengthen their system of internal controls. These providers are expending state funds for goods and/or services without ensuring that the purchases being made are for reasonable, allocable, and allowable items. Additionally, some providers did not use sound business judgment when utilizing state funds. Such poor judgment has caused two agencies to experience serious cash-flow problems and, in one instance, has led to the closing of the provider agency. Finally, we found that some providers need to be instructed in the proper use of state funds, which cannot be used in any manner they deem suitable. The unallowable expenses are as follows: 4

   a. <u>Two Social Service Providers Expended Commonwealth Funds Totalling Approximately $118,500 to Benefit Out-of-State Programs</u>: Two social service providers--Brown and Sullivan, Inc., and The Key Program, Inc.,--utilized Commonwealth funds totalling approximately $118,500 for expenses that benefited out-of-state programs. Specifically, Brown and Sullivan offset an $80,654 operating deficit in its Connecticut-based programs with funds provided by the Commonwealth of Massachusetts. Moreover, Brown and Sullivan shared two vehicles within its Massachusetts- and Connecticut-based programs. However, the cost to operate these vehicles, approximately $34,000, was funded solely by the Commonwealth. In addition, we found that the Key Program utilized Commonwealth funds totalling $3,920 for travel and consultant costs that were related to the provider's efforts to expand its operations into New York State. 5

   b. <u>Brown and Sullivan, Inc., Employed Two Executive Directors, Which Resulted in Unnecessary Costs to the Commonwealth and Enabled One Director to Subordinate His Administrative Responsibilities at the Agency in Favor of a Daytime Teaching Position at Two Local Colleges</u>: Brown and Sullivan, Inc., employed Co-Executive Directors. This management arrangement, which violates state regulations, resulted in unreasonable costs to the Commonwealth totalling $58,812. 7

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In addition, it enabled one Director to subordinate his administrative responsibilities at the agency in favor of a daytime teaching position at two local colleges. The Director's absence from the agency, which has occurred since September 1991, demonstrates disregard for safeguarding the Commonwealth's assets and has contributed to Brown and Sullivan, Inc.'s numerous fiscal problems which are detailed throughout this report.

c. Scovell and Schwager, Inc., Utilized State Funds Totalling $86,274 for Excessive Pension Benefits, Questionable Salary Payments, Unnecessary Vehicle Expenses, and Gifts: Scovell and Schwager utilized state funds totalling $86,274 for expenses that did not directly relate to the program purposes of the agency. The expenses, which violated state contracting regulations, generally benefitted the agency's Chief Executive Officer (CEO) and/or the CEO's spouse. The unallowable expenses consisted of excessive pension benefits totalling $65,416, improper salary payments totalling $8,941; unnecessary vehicle expenses totalling $9,654; and payments totalling $2,263 for gifts and entertainment expenses. 10

d. The Center for Human and Health Services, Inc., Provided Its President with an Excessive Fringe Benefit Package that Cost the Commonwealth $35,571: The Center for Human and Health Services, Inc., (CHHS) provided its president with a fringe benefit package that violated state regulations. Specifically, CHHS maintained an unqualified pension plan exclusively for its president. The special plan, which supplemented the agency's regular employee pension plan, cost CHHS $30,868 during fiscal year 1993. Additionally, CHHS provided its president with a $700,000 whole life insurance policy. The insurance policy cost CHHS $4,703 and was offered exclusively to the president. In each instance, CHHS utilized state funds to pay for the president's benefits. 18

e. Brown and Sullivan, Inc., Violated State Regulations by Loaning Employees $10,539 in State Funds: Brown and Sullivan utilized state funds totalling $10,539 for employee loans. Since the loans were not provided for in the program budgets of Brown and Sullivan and since Brown and Sullivan does not have any privately generated funds of its own to use, this is an unauthorized use of Commonwealth program funds, and the propriety of such a transaction is questionable. 20

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f. Brown and Sullivan, Inc., Incurred Interest and Penalties Totalling $73,471 Due to the Late Payment of Payroll Taxes: Brown and Sullivan failed to remit payroll taxes to the Massachusetts Department of Revenue (DOR), the Massachusetts Department of Employment and Training (DET), and the Internal Revenue Service (IRS) on time. Consequently, the DOR, DET, and IRS assessed the agency interest and penalties totalling $73,471 for the period July 1, 1991 through September 30, 1993. To cover these charges, Brown and Sullivan utilized state contract funds. However, according to state regulations, interest and penalties resulting from delinquent tax payments are unallowable contract costs. 22

g. Life Resources, Inc., Provided Unnecessary Christmas Bonuses Totalling $5,025: During December 1992, Life Resources provided Christmas bonuses totalling $5,025 to its administrative and direct care staff. The agency utilized state funds for bonuses of up to $800. Such bonuses represent non-program expenses, which, under 808 CMR 1.15(12), are defined as "expenses of the provider which are not directly related to the social service program purposes of the provider." Additionally, under 808 CMR 1.15, such cost are classified as nonreimbursable and are subject to recoupment by the Commonwealth. 23

h. The Key Program, Inc., Utilized State Funds Totalling $4,091 for Unnecessary College Tuition Reimbursements: During the autumn of 1992, the Director of Administration and Finance of The Key Program attended law school at Western New England College. The Director was enrolled in four courses that included Contracts, Civil Procedures, Torts, and Lawyering Process. Because the administrator successfully completed each course, The Key Program utilized state funds totalling $4,091 to reimburse his tuition expenses. Because the Director's pursuit of a law degree does not directly relate to the program purposes of the agency, The Key Program violated state regulations governing the pricing, reporting and auditing of purchased social service programs by providing the Director's tuition reimbursement. 24

i. Eight Providers Had Inadequate Internal Controls over Their Telephone Systems Which Resulted in Unallowable Costs Totaling $18,026: Contrary to sound business practices, 18 human service providers had not established an adequate system of internal controls over the use of their telephone systems by members of their staff. Specifically, the providers did not maintain adequate documentation to support the programmatic need for long-distance telephone calls. Additionally, the providers had not established procedures to identify and 25

recover reimbursement for the personal calls made by provider staff. Most providers considered all of their telephone calls to be business-related, unless an employee reported otherwise. Consequently, the providers utilized state funds totalling $18,026 for interstate, overseas, and 1-900 telephone calls that were not related to the program purposes of these agencies.

j. Beaverbrook Step, Inc., Awarded Salary Bonuses Totalling $43,795 in an Inequitable Manner: Six of the 18 human service providers awarded salary bonuses totalling $977,089 during fiscal year 1993. The six providers utilized state funds to accommodate the bonuses and, with the exception of Beaverbrook Step, awarded the bonuses in a manner consistent with state regulations. However, Beaverbrook Step violated 808 CMR 1.15 by limiting its Christmas bonuses to three top administrative staff. Also, the agency failed to distribute a second bonus package in a fair and equitable manner among all of its employees. Consequently, Beaverbrook Step should return to the Commonwealth the $43,795 in state funds that were used improperly for Christmas and salary bonuses. 28

2. Sixteen Providers Purchased $45,234 in Questionable Items with State Funds: We found numerous instances in which human service providers paid thousands of dollars for goods and/or services that did not directly relate to the social service program purposes. Specifically, 16 of the 18 providers (89%) utilized state contract payments totalling $45,234 for items such as office parties, meals, floral arrangements, and entertainment. Such discretionary purchases represent a questionable use of state contract funds because they do not benefit the clients. 31

3. Seven Providers Did Not Maintain Adequate Records and Supporting Documentation for $788,191 in Expenses Charged to State Contracts: We examined a sample of administrative expenditures made by the 18 human service providers to determine whether each provider maintained records and documents that adequately supported contract expenditures. During fiscal year 1993, seven providers expended state funds totalling $788,191 without adequate supporting documentation. Specifically, documentation was found to be lacking in the areas of consultant services, personal use of administrative vehicles, time and attendance reports for administrative staff, and receipts for office expenses. 34

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4. __Nine Providers Incorrectly Reported $559,048 in Program Costs__: Nine of the 18 human service providers, due primarily to inadequate internal controls over the proper classification of direct and indirect costs, incorrectly reported program costs to DPS. Specifically, seven providers reported direct program costs totalling $298,759 as administrative expenses on their fiscal year 1993 Uniform Financial Statements and Independent Auditor's Report (UFR). Conversely, two providers reported administrative costs totalling $260,289, as direct program expenses. In doing so, the nine providers did not provide the Commonwealth with the actual results of their fiscal year 1993 operations and hindered the Commonwealth's efforts to collect, analyze, control, and report social service costs. 41

5. __Five Providers Had Not Developed an Allowable Cost Allocation Plan__: Five of the eighteen human service providers had not established an allowable plan for allocating their indirect/common costs (i.e., costs that benefit more than one function) to state contracts. Under DPS guidelines, social service providers are required to allocate indirect costs on a usage/benefit basis. However, during fiscal year 1993, Vinfen Corporation; Gandara Mental Health Center, Inc.; and Beaverbrook Step, Inc., allocated $3,934,438 of indirect costs based upon available contract revenues. This allocation method is specifically prohibited by DPS. Additionally, Haverhill/ Newburyport Human Services, Inc., utilized an obsolete plan to allocate $298,908 of its administrative salaries and occupancy costs to state contracts. Finally, Scovell and Schwager, Inc., allocated $287,401 in administrative salaries between state contracts and non-program-related activities without the benefit of a cost allocation plan. Consequently, the five providers cannot ensure that the indirect expenses charged to their state contracts were reasonable, allowable, and allocable. 46

CONCLUSIONS AND RECOMMENDATIONS 52

The results of our review indicate that significant problems relative to the expenditure, classification, and reporting of indirect costs existed at the 18 human service providers we audited. As noted throughout our report, these problems were caused by a variety of factors, including the service providers' (1) inadequate systems of internal controls over their operations, (2) lack of sound business judgment, and (3) lack of awareness that certain indirect expenses they incurred were unallowable and nonreimbursable under state regulations.

Additionally, neither DPS nor state purchasing agencies have established and implemented effective fiscal monitoring policies and procedures over contracted human service providers to ensure that all indirect costs incurred by providers are reasonable, allowable, and allocable to state contracts. In addition, our audit of 40 social service providers and five state agencies

found that DPS and state purchasing agencies have not developed and implemented effective fiscal monitoring procedures over contracted service providers (see Audit Report No. 93-4001-3). This report notes that, although, according to DPS officials, the UFR is the primary vehicle used by the state to provide adequate oversight of provider agencies, DPS does not have the resources (e.g., staff) to perform routine analytical reviews of the vast majority of the approximately 900 complete UFRs it receives annually. This report also notes that state agencies utilize UFR information solely to prequalify human service providers for possible state contract awards.

As a result of audits completed by the OSA, DPS has taken some measures to address our concerns relative to the allowability of human service provides costs. Specifically, in August 1993, DPS issued a summary sheet (DPS A035-93 Rev.), which further defined reimbursable and nonreimbursable costs. In this publication, DPS provides its interpretation of what types of costs would be considered nonreimbursable in accordance with their regulations. Also, during fiscal year 1993 DPS amended its regulations to include the following as a nonreimbursable cost:

> Unallowable Costs under OMB Circular A-122 and A-21: Costs which are not allowable under OMB Circular A-122 and A-21 are non-reimbursable to programs which receive Federal financial assistance.

Finally, as a result of our audit work, DPS amended its regulations effective July 1, 1994 (fiscal year 1995) to include the following as a nonreimbursable costs: luxury items, salaries of officers and managers, mortgage principal, undocumented expenses, and administration and support costs.

Although DPS has taken measures to clarify to service providers what costs are nonreimbursable under state contracts, additional measures are necessary to ensure that indirect expenses being charged against state contracts are appropriate, reasonable, and properly classified and reported, as follows:

1. DPS should implement the recommendations noted in OSA Audit Report No. 93-4001-3 relative to improving the state's monitoring of contracted service providers.

2. DPS should develop an internal control guide for service providers. In conjunction, DPS should amend its regulations to require service providers to utilize the guide to develop and implement an adequate internal control structure. DPS should also require providers to submit standard documentation with their UFR each year that details their system for safeguarding the Commonwealth's assets. Such control systems should help to eliminate the types of problems we identified throughout this report.

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3. State purchasing agencies, in conjunction with DPS and other interested parties, should identify business administration training opportunities and provide this information to contracted service providers. DPS, in conjunction with state purchasing agencies, should also provide regular training sessions on various pertinent business administration topics to provider staff.

4. DPS should take measures to recover the $454,104 in unallowable expenditures that we identified at the 18 human service providers. Additionally, DPS should determine whether the 18 providers need to return any additional amounts due to prior years unallowable expenses.

5. GMHC; Vinfen Corporation; Beaverbrook Step, Inc.; Scovell and Schwager, Inc.; and HNHS should develop and utilize a cost allocation plan in accordance with GAAP to ensure that all programs, not only state-funded programs, receive their fair and equitable share of all costs associated with providing a particular service.

6. The nine providers that incorrectly reported $559,048 in program costs to DPS should establish and implement policies and procedures that ensure that their fiscal offices utilize OMB's cost principles when reporting program expenses to DPS. Also, each provider should amend its fiscal year 1993 UFR to reflect actual program costs for the period. Copies of the amended return should be submitted to appropriate state agencies.

As a result of the conditions noted here and in Audit Report No. 93-4001-3, the Office of State Auditor is making recommendations for the reform of the Commonwealth's purchase-of-service system for its social and human service programs.

APPENDIX 55

Funding Sources for 18 Human Service Providers Audited

INTRODUCTION

Background

The amount of social services the state purchases through its purchase-of-service (POS) system has dramatically increased over the past two decades from approximately $25 million in 1971 to approximately $1.6 billion during fiscal year 1993. The increase in state expenditures for purchased services has been attributed to several factors, including a philosophical change in how mentally ill, mentally retarded, and juvenile offenders should be treated; the de-institutionalization of clients residing in state mental health facilities brought about by consent decrees issued in the early 1970's; and the desire of the administration to reduce the size of state government by purchasing, rather than directly providing, these services.

Currently, the Division of Purchased Services (DPS) has responsibility for implementing and coordinating an efficient and accountable system of procurement, selection, pricing, contract administration, program monitoring and evaluation, contract compliance, and post audit for any state agency that procures or pays for social services programs from contracted service providers. Contracted service providers and state agencies that procure POS-related services are required to comply with all applicable DPS regulations and guidelines.

The objectives of our audit were to determine whether contracted human service providers (1) allocated indirect costs to state contracts in a manner consistent with DPS and the federal Office of Management and Budget (OMB) guidelines; (2) developed and implemented an adequate system of internal controls over the authorization, recording, and reporting of indirect costs; and (3) incurred indirect costs that were reasonable, allowable, and allocable to state contracts. In order to meet these objectives, we conducted audits of 18 human service providers, located throughout the Commonwealth, that received

contracts from the departments of Mental Retardation (DMR), Mental Health (DMH), Social Services (DSS), Public Welfare (DPW), Public Health (DPH), and Youth Services (DYS); the Massachusetts Commission for the Blind (MCB); and the Massachusetts Rehabilitation Commission (MRC). During fiscal year 1993, the 18 human service providers' revenue totalled $127 million (see Appendix), of which approximately $89 million represented state contracts.

During our audits, we identified 17 deficiencies involving over $6.3 million in state funds. These deficiencies, which were primarily the result of inadequate internal controls within the service providers' contract management systems, warrant immediate attention and action by the providers and DPS.

Audit Scope, Objectives, and Methodology

The scope of our audit included an examination of each provider's activities during fiscal year 1993 relative to their state-funded contracts. The objectives of our audit were to determine whether (1) each provider's cost allocation plan ensured that the provider's indirect costs were allocated to state contracts in a manner consistent with DPS and the federal Office of Management and Budget (OMB) guidelines; (2) each provider had developed and implemented an adequate system of internal controls over the authorization, recording, and reporting of its indirect costs; and (3) the indirect costs incurred by each provider were reasonable, allowable, and allocable to state contracts. Our audit was conducted in accordance with generally accepted government auditing standards for performance audits issued by the Comptroller General of the United States and included such tests as we considered necessary under the circumstances.

To meet our objectives, we interviewed provider officials and reviewed organizational charts and internal control policies and procedures. We also assessed the systems of internal controls established and implemented by each provider over their operations to obtain an understanding of the control

environment and the flow of transactions through the agency. We used this assessment in planning and performing our audit tests. We also reviewed all applicable laws, rules, and regulations, and examined each provider's financial statements, budgets, cost reports, invoices, and other pertinent financial records.

Our audit was not made for the purpose of forming an opinion on each provider's financial statements. Also, we did not assess the quality and appropriateness of program services provided by each provider from its state-funded contacts. Rather, our report was intended to report findings and conclusions on (1) the extent of each provider's compliance with applicable laws, rules, and regulations; (2) the allowability, allocability, and reasonableness of program expenditures; and (3) the effectiveness of each provider's internal controls over program expenditures.

Upon completion of each audit, we met with provider officials to discuss the results of our audit. During these meetings, we detailed the audit deficiencies that we found and afforded each provider the opportunity to provide any additional information. We also advised each provider to prepare a written response for each audit deficiency. Eight of the 18 providers chose to respond formally. As we prepared this audit report, we considered each provider's responses and, where appropriate, incorporated them into the text of the report.

AUDIT RESULTS

1. Human Service Providers Utilized State Funds Totalling $454,104 for Purposes Prohibited by DPS Regulations

Eleven of the 18 human service providers expended state funds totalling $454,104 on goods and services that, according to state regulations, were nonreimbursable under state contracts. Of this amount, $209,997 was utilized by the provider agencies for payments benefiting out-of-state programs, interest and penalty charges resulting from delinquent state and federal payroll taxes, and personal long-distance telephone calls. Additionally, employees of the 11 human service providers received extraordinary benefits totalling $244,107. For example, several administrators received exorbitant life insurance policies, pension benefits, and salary bonuses. We also found that provider staff received personal loans, gifts, college tuition reimbursements, and vehicles for their personal use.

The 11 human service providers can avoid similar problems in the future by developing policies and procedures that ensure the proper use of state funds. Presently, several providers need to strengthen their system of internal controls. These providers are expending state funds for goods and services without ensuring, based upon state regulations, that the purchases being made are for reasonable, allocable, and allowable items. Additionally, some providers did not use sound business judgment when utilizing state funds. Such poor judgment has caused two agencies to experience serious cash-flow problems, and in one instance the problems have led to the closing of a provider agency. Finally, we found that some providers need to be instructed in the proper use of state funds.

Several of the providers believed that they could utilize state funds in

any manner that they deemed suitable. This attitude has led to a significant waste of taxpayer dollars. The following sections provide a detailed explanation of the problems we found during our review relative to nonreimbursable expenses.

a. Two Social Service Providers Expended Commonwealth Funds Totalling Approximately $118,500 to Benefit Out-of-State Programs: Two social service providers--Brown and Sullivan, Inc., and The Key Program, Inc.,--utilized Commonwealth funds totalling approximately $118,500 for expenses that benefited out-of-state programs. Specifically, Brown and Sullivan offset an $80,654 operating deficit in its Connecticut-based programs with funds provided by the Commonwealth of Massachusetts. Additionally, Brown and Sullivan shared two vehicles within its Massachusetts- and Connecticut-based programs. However, the cost to operate these vehicles, approximately $34,000, was funded solely by the Commonwealth. At The Key Program, we found that the provider utilized Commonwealth funds totalling $3,920 for travel and consultant costs that were related to the provider's efforts to expand its operations into New York State.

By utilizing Commonwealth funds in this manner, Brown and Sullivan and The Key Program violated state regulations that govern the pricing, reporting, and auditing of purchased social service programs. Specifically, 808 Code of Massachusetts Regulations (CMR) 1.15(12) states that the following shall be nonreimbursable costs:

> Non-Program Expenses: Expenses of the provider which are not directly related to the social service program purposes of the provider.

During fiscal year 1993, the Commonwealth of Massachusetts awarded Brown and Sullivan 15 social service contracts for the purpose of serving mentally and physically handicapped individuals residing within the Commonwealth. During the year, Brown and Sullivan generated excess funds from these contracts totalling $190,867. Brown and Sullivan should have utilized these

funds to benefit its Massachusetts-based programs. For example, Brown and Sullivan could have initiated capital improvements to its residential properties, reduced their outstanding tax liability (see Audit Result No. 1f) or set the funds aside for future working capital requirements of the agency.

However, Brown and Sullivan opted to utilize $80,654 of the excess funding to eliminate a deficit within its Connecticut-based programs. In doing so, it clearly violated 808 CMR 1.15(12), since the program deficit did not directly relate to the social service programs purchased by the Commonwealth. Additionally, Brown and Sullivan further disregarded its responsibility to safeguard the Commonwealth's assets by failing to establish an accounts receivable to ensure recovery of the $80,654 from the state of Connecticut.

Brown and Sullivan also allowed two vehicles, which were funded through Massachusetts contracts, to be used within its Connecticut-based programs. One of the vehicles, a 1990 Buick Century, was provided to a Program Manager who spends approximately 40% of his time managing the agency's Connecticut-based programs. The second vehicle, a 1992 Ford van, was acquired for a DMR residential program located in Chicopee, Massachusetts. However, the driver and the monitor of the van live in Connecticut and use the vehicle for commuting to and from Massachusetts each day. Additionally, the monitor is a client of the Connecticut-based residential program, at which location the van is garaged each night. The monitor therefore directly benefits from the use of the van. Finally, the cost to operate the van and the Buick Century totalled approximately $34,000 during fiscal years 1992 and 1993. This cost should have been allocated between Massachusetts and Connecticut contracts. The table below details the vehicle costs during the past two fiscal years.

Vehicle	Operating Expense	Fiscal Year 1992 Amount	Fiscal Year 1993 Amount	Total Cost
1990 Buick Century	Vehicle Lease	$3,975	$3,796	$ 7,771
	Gasoline	1,638	-	1,638
	Vehicle Insurance	1,132	1,575	2,707
	Repairs	331	880	1,211
Subtotal		$7,076	$6,251	$13,327
1992 Ford Van	Loan Payment	$4,205	$5,606	$9,811
	Gasoline	4,130	4,114	8,244
	Vehicle Insurance	1,125	1,500	2,625
Subtotal		$9,460	$11,220	$20,680

Finally, The Key Program utilized state funds to expand its operations outside the Commonwealth. Specifically, during July and August 1992, the provider attended conferences, employed a consultant, and incurred transportation and dining expenses totalling $3,920 in an effort to expand into New York State. The Executive Director of The Key Program agreed that the charges violate 808 CMR 1.15(12) and stated that revenue sources other than state contracts would be used for any future expansion efforts. The table below details the unallowable costs charged to the Commonwealth by The Key Program, Inc.

Date	Item of Expense	Cost	Check Number
07/02/92	Consultant	$ 126	37545
07/07/92	Consultant	378	37545
08/04/92	Consultant	504	37545
07/07/92	Consultant	378	37545
08/19/92	Consultant	882	37545
08/20/92	Consultant	378	37545
08/17/92	Hotel and Local Transportation	554	31818
08/17/92	Limousine Service	546	31279
08/19/92	Dining Expense	174	37192
Total		$3,920	

b. Brown and Sullivan, Inc., Employed Two Executive Directors, Which Resulted in Unnecessary Costs to the Commonwealth and Enabled One Director to Subordinate His Administrative Responsibilities at the Agency in Favor of a Daytime Teaching Position at Two Local Colleges: Contrary to state

regulations, Brown and Sullivan employed Co-Executive Directors. This management arrangement resulted in unreasonable costs to the Commonwealth totalling $58,812. In addition, it enabled one Director to subordinate his administrative responsibilities at the agency in favor of a daytime teaching position at two local colleges. The Director's absence from the agency, which has occurred since September 1991, demonstrates a disregard for safeguarding the Commonwealth's assets and has contributed significantly to Brown and Sullivan's numerous fiscal problems, which are detailed throughout this report.

In purchasing a social service program, the Commonwealth will not pay for expenses that have been identified under state regulations as "unreasonable costs." Specifically, 808 CMR 1.15(1) defines unreasonable costs as:

> Any amount paid for goods or services which is greater than either the market price or the amount paid by comparable agencies or governmental units within or outside of the Commonwealth.

Brown and Sullivan's employment of Co-Executive Directors costs the Commonwealth $100,000 per year in salary expenses. A significant portion of this amount, $42,414, represents an unreasonable cost to the Commonwealth, since comparable human service agencies reviewed during the audit employed one Executive Director at an average cost of $57,586 per year. In total, six of the 18 providers reviewed received comparable funding and managed similar programs as Brown and Sullivan. Yet, only Brown and Sullivan employed Co-Executive Directors. Additionally, a Senior Program Specialist for the Department of Mental Retardation stated that, to his knowledge, no other provider employs Co-Executive Directors. Finally, over the past few years, the Office of the State Auditor (OSA) has audited numerous nonprofit human service providers that are comparable in size and in function to Brown and Sullivan. However, Brown and Sullivan is the only provider that the OSA

found to employ Co-Executive Directors. The table below provides data for fiscal year 1992 operations of the five comparable providers reviewed during our statewide audit.

Human Service Provider	State Funding	Total Funding	State Contracts Received	Executive Director's Salary
Community Enterprises, Inc.	$2,822,187	$5,340,869	25	$ 66,148
Gandara Mental Health Center, Inc.	$2,335,999	$4,016,353	19	53,695
The Bridge of Central Mass., Inc.	$4,021,876	$4,370,015	19	56,571
Haverhill/Newburyport Human Services, Inc.	$2,239,789	$3,511,863	17	44,050
Charles River Association For Retarded Citizens	$1,728,150	$3,950,372	18	67,466
				$287,930

As the chart indicates, the salaries of the five Executive Directors totals $287,930, which calculates to an average salary of $57,586.

With the availability of Co-Executive Directors, Brown and Sullivan should have maintained a highly efficient operation that utilized internal controls and management oversight to safeguard the Commonwealth's assets. However, the management arrangement simply allowed one Executive Director to subordinate his management responsibilities in favor of teaching at two local colleges. Since September 1991, the Executive Director has spent a significant amount of time away from Brown and Sullivan teaching psychology and sociology courses at Springfield Technical Community College (STCC) and Holyoke Community College (HCC). During this time, the Executive Director has continued to draw a full salary from Brown and Sullivan, and to collect his teaching fees, which totalled $16,398. The table below details the Executive Director's activities at STCC and HCC.

Educational Facility	Semester	Schedule	Course Fee
HCC	Fall 1991	Tues/Thur 11-12:15pm	$ 1,605
HCC	Fall 1991	Tues/Thur 2- 3:15pm	1,605
HCC	Spring 1992	Tues/Thur 2- 3:15pm	1,605
HCC	Fall 1992	Tues/Thur 12:30-1:45pm	1,926
HCC	Fall 1992	Tues/Thur 2- 3:15pm	1,926
HCC	Spring 1993	Tues/Thur 2- 3:15pm	1,926
STCC	Fall 1993	Mon/Wed/Fri 8:30-9:20am	1,935
STCC	Fall 1993	Mon/Wed/Fri 9:35-10:25am	1,935
STCC	Spring 1994	Tues/Thur 10-11:15am	1,935
Total			$16,398

Brown and Sullivan's officials contended that the Executive Director compensated the agency for his absence by working evenings and weekends on agency matters. However, the Co-Executive Director did not maintain time and attendance records or any other form of supporting documentation, which is required under state regulation 808 CMR 2.00, Section VI, which states, in part:

> The provider shall maintain personnel records for each employee including payroll and time and attendance records documenting program assignment and hours and days worked...

Finally, regardless of whether the Executive Director works at home, his full-time daily presence is mandatory at Brown and Sullivan since one of the Executive Director's primary responsibilities at the agency is to safeguard the Commonwealth's assets. However, as noted throughout this report, Brown and Sullivan has wasted thousands of taxpayer dollars through mismanagement. The Executive Director has contributed significantly to the agency's problems by abandoning his fiscal responsibilities in favor of his teaching endeavors.

c. Scovell and Schwager, Inc., Utilized State Funds Totalling $86,274 for Excessive Pension Benefits, Questionable Salary Payments, Unnecessary Vehicle Expenses, and Gifts: Scovell and Schwager utilized state funds totalling

$86,274 for expenses that did not directly relate to the program purposes of the agency. The expenses, which violated state contracting regulations, generally benefitted the agency's Chief Executive Officer (CEO) and/or the CEO's spouse. The unallowable expenses consisted of excessive pension benefits totalling $65,416; improper salary payments totalling $8,941; unnecessary vehicle expenses totalling $9,654; and payments totalling $2,263 for gifts and entertainment expenses. The details concerning each of these expenditures are provided in the ensuing subsections.

o Excessive Pension Benefits: On December 31, 1992, Scovell and Schwager, disbursed $230,000 to its CEO as a prepaid retirement benefit. Since that date, Scovell and Schwager has allocated a portion of the benefit, $65,416, to its state contracts in violation of state regulations. Specifically, 808 CMR 1.15(9) identifies the following as a nonreimbursable cost:

> Fringe benefits determined to be excessive in light of salary levels and benefits of other comparable providers and fringe benefits to the extent that they are not available to all employees under an established policy of the provider.

Scovell and Schwager has an established pension plan for all of its employees, including the CEO. However, the $230,000 prepaid retirement benefit was not a part of the agency's formal pension plan, but rather a special retirement bonus provided exclusively for the CEO. Consequently, based upon 808 CMR 1.15(9), the CEO's pension represents a nonreimbursable expense. Additionally, although the OSA has examined pension benefits offered by numerous human service agencies throughout the Commonwealth, this is the first instance that it has found of a human service agency providing such a lucrative benefit to a retiring executive officer.

Scovell and Schwager began allocating the prepaid retirement expense to its state contracts on January 31, 1993. Through June 31, 1994 the

agency has charged a total of $65,416 to state contracts and $16,360 to non-state contracts. The table below details the agency's monthly allocation of the CEO's retirement benefit.

Date	Total Allocation	State Contract Expense	Non-State Contract Expense	Balance
				$230,000
01/31/93	$14,000	$11,200	$ 2,800	216,000
02/28/93	14,000	11,200	2,800	202,000
03/31/93	14,000	11,200	2,800	188,000
04/30/93	14,000	11,200	2,800	174,000
05/31/93	(1,280)	(1,024)	(256)	175,280
06/30/93	(10,000)	(8,000)	(2,000)	185,280
07/31/93	3,088	2,470	618	182,192
08/31/93	3,088	2,470	618	179,104
09/30/93	3,088	2,470	618	176,106
10/31/93	3,088	2,470	618	172,928
11/30/93	3,088	2,470	618	169,840
12/31/93	3,088	2,470	618	166,752
01/31/94	3,088	2,470	618	163,664
02/28/94	3,088	2,470	618	160,576
03/31/94	3,088	2,470	618	157,488
04/30/94	3,088	2,470	618	154,400
05/31/94	3,088	2,470	618	151,312
06/30/94	3,088	2,470	618	148,224
Totals	$81,776	$65,416	$16,360	

Following the completion of our audit, Scovell and Schwager responded in writing to our concerns over the CEO's prepaid retirement benefit. The agency contended that the expenditure was not a retirement fringe benefit, but rather a prepaid salary expense. Scovell and Schwager's complete response, which was prepared by the agency's private accountant, is provided below.

> As regards the salary prepaid to the CEO in December, 1992, in the amount of $230,000, they think that there is a mis-characterization of the purpose of this expenditure by your office. The expenditure was not a retirement fringe benefit; the purpose was to assure the providers' of having Mr. Scovell's unique and invaluable services over a substantial period of time but at a reduced commitment of his time. Mr. Scovell intended, and continues to this day, to remain active in the business which he created; the annual charges to the business accurately reflect the gradual reduction of his time during the first half of calendar 1993 from full-time to approximately 40%, a level of commitment which he presently maintains. Only $45,000 of expense was charged during that fiscal year, and approximately $35,000 will be charged during this current year. Future expenses charged against the prepayment will be determined by actual work provided by Mr. Scovell.

The prepayment arrangement was setup as part of a general strategy for Mr. Scovell's estate and tax planning. They felt that tax rates were likely to increase substantially in 1993, and that prepayment was a prudent and legitimate way to minimize taxes. Furthermore, it was believed that recording a liability to Mr. Scovell for future services would aid in the eventual transfer of ownership of the company to his partner.

Although Scovell and Schwager's private accountant argues that the $230,000 payment represents a prepaid salary expense, we still contend that the payment represents a prepaid retirement benefit to the CEO for the following reasons:

- Scovell and Schwager's financial records (i.e., cash disbursement journal and general ledger) categorize the $230,000 payment as a prepaid retirement expense.

- Scovell and Schwager's CEO, President, and Fiscal Officer were informed about our concerns during and at the close of our audit engagement. Throughout the audit, we addressed the $230,000 expense as a prepaid retirement benefit. At no point did the officials question our classification of the expense. Furthermore, at the exit interview, which was also attended by the agency's private accountant, the officials acknowledged the expense as a retirement benefit and stated that similar benefits are not available to all agency employees. At the exit conference, the officials also stated that the CEO was entitled to the retirement benefit based upon his many years of dedicated service as a human service provider.

- Scovell and Schwager's private accountant is correct in stating that there is no regulation against prepaid expenses. In fact, prudent business practice would typically result in the prepayment of certain expenses (e.g., insurance, rent, leases) for periods of up to one year. However, salaries are typically paid at the time they are earned. By prepaying an individual's salary, an organization can be harmed financially if the individual becomes incapacitated and is unable to continue working. Furthermore, if Scovell and Schwager's $230,000 payment to the CEO was a prepaid salary expense, it would represent approximately eight years of his salary ($230,000/$40,000 per year). Such a prepayment is unwarranted under any condition.

- Following Mr. Scovell's retirement, the agency continued to provide the CEO with a salary of $880 per month. The agency maintained Mr. Scovell on its payroll because the CEO continued to remain somewhat active in the agency's operations. Unlike the prepaid retirement expense, the agency accounted for the $880 as a salary payment within its payroll journal and general ledger.

o <u>Questionable Salary Payment</u>: During fiscal year 1993, the CEO's spouse received a $9,825 salary from the agency, of which $8,941 was charged to state

contracts. Our audit revealed that the CEO's spouse provided no daily function for the agency and was basically a "no-show" employee. The agency added the CEO's spouse to its payroll in a contrived attempt to reduce the yearly health insurance costs for the CEO and his family. Unquestionably, the salary payment violated state regulations. Additionally, by creating a "no-show" employee, the CEO avoided additional state and federal income taxes and increased the federal government's liability regarding future social security benefits for his spouse.

In purchasing a social service program, the Commonwealth will not pay for expenses that have been identified in 808 CMR 1.15(1)-(22) as "nonreimbursable" costs. Identified within the provisions of 808 CMR 1.15 are non-program expenses which the Commonwealth defines as, "Expenses of the provider, which are not directly related to the social service program purposes of the provider." Clearly, such salary payments represent a non-program expense.

During our exit conference with Scovell and Schwager, we informed the provider about our concerns regarding the employment status of the CEO's spouse. At that time, the CEO stated that his spouse is the clerk of the organization and that, for the past 10 years, she has worked for Scovell and Schwager as an as-needed adviser/consultant on issues relating to health services to children and youths. The CEO, however, conceded that his spouse has no daily responsibilities at the agency and that she does not maintain any time and attendance records to support her salary charges to the state. Additionally, the CEO admitted that his spouse was added to the agency's payroll in an effort to reduce his cost of health insurance.

Following the exit conference, Scovell and Schwager's private accountant confirmed in writing most of the information offered by the CEO about his spouse's status. Specifically, the private accountant stated:

With respect to the employment of Cynthia Scovell, she has worked for S & S for over ten years as clerk of the corporation and as an as-needed consultant/adviser on issues relating to health services to children and youths, an area where her experience with the DYS and 766 schools has made her a recognized expert. She was not paid for the majority of that time. She has a job description on file.

Some years ago, the health care premiums for this small provider's increased dramatically and it became substantially cheaper to insure Melvin and Cynthia Scovell under individual policies rather than under a family policy. In order to be eligible for an individual policy, Mrs. Scovell had to be on the payroll. This action has not increased costs to the state, because Cynthia's salary has been funded by decreasing Mr. Scovell's salary by a like amount. Since Scovell and Schwager, Inc., is a Subchapter S Corporation, the only consequence of putting her on the payroll was to save money on an allowable fringe benefit.

However, contrary to the private accountant's contention, the consequences of Scovell and Schwager's action was not limited to a financial savings on an allowable fringe benefit, but also adversely affected the financial position of the state and federal governments.

- The Scovells avoided state and federal income taxes by enrolling Mrs. Scovell in a separate health insurance plan. As an employee of Scovell and Schwager, Mrs. Scovell is not required to pay income taxes on fringe benefits. However, as a part owner of a Subchapter S Corporation, Mr. Scovell would have been required to pay income taxes on the additional cost to carry his spouse under a family health insurance plan.

- As an employee of Scovell and Schwager, Mrs. Scovell could collect unemployment benefits from the Commonwealth if the agency lays her off from work.

- During her "no-show" employment with Scovell and Schwager, Mrs. Scovell contributed to the Social Security Administration's retirement plan. Mrs. Scovell's contributions to the plan could eventually increase her retirement benefits from the federal government.

- As an employer of Mrs. Scovell, Scovell and Schwager is required to pay social security taxes and unemployment taxes on her salary. The agency eventually charges these taxes to the Commonwealth under its state cost reimbursement contracts.

- Finally, Scovell and Schwager is required each year to complete DPS's Uniform Financial Statements and Independent Auditor's Report (UFR). By creating a "no-show" employee, Scovell and Schwager failed to provide the Commonwealth with the actual results of its fiscal year 1993 operations and hindered the Commonwealth's efforts to collect, analyze, control, and report social service costs.

o Unnecessary Vehicle Expenses: During fiscal year 1993, Scovell and Schwager, provided its CEO and his spouse with automobiles. The CEO received a 1992 Accura, which he primarily used for personal matters. His spouse received a 1989 Accura, which she used exclusively for personal travel. Scovell and Schwager, charged the Commonwealth $9,654 to operate the vehicles, which included expenses for depreciation, insurance, excise tax, gasoline, and repairs. These charges violated state regulations that prohibit the Commonwealth from reimbursing human service providers for non-program expenses. Specifically, 808 CMR 1.15(12) defines non-program expenses as "Expenses of the provider, which are not directly related to the social service program purposes of the provider."

The CEO admitted that his spouse does not require a vehicle for her work at Scovell and Schwager. Furthermore, the CEO stated that, since his spouse utilizes the 1989 Accura exclusively for personal matters, he was considering buying the vehicle from the agency. Following the audit, the CEO's comments were confirmed in writing by the agency's private accountant, who stated:

- The car used by Cynthia Scovell had been a provider's car formerly used by Mel Scovell, which she took over when he was provided with a new car. The understanding was that she would reimburse the providers for all expenses, and, in fact, they are prepared to certify that there were no charges for gas, oil, repairs and maintenance, parking, tolls, and other usual automobile expenses. Insurance expense and excise tax paid by the providers slipped through their control procedures and was not consistent with the policy they had established.

- To clear up this matter, Mrs. Scovell will shortly purchase the car from the provider, thereby eliminating the problem.

We found the private accountant's comments to be accurate with one exception: Scovell and Schwager, also charged the Commonwealth depreciation expenses totalling $1,342 on Mrs. Scovell's automobile during fiscal year 1993.

Concerning his own vehicle, the CEO claimed that approximately 65% of its use is business-related. However, the CEO did not maintain a vehicle usage

log to support his claim. Furthermore, when we asked him to identify typical business travel, he cited trips to (1) his partner's home, (2) the company business office, and (3) the company's two program sites. Such travel represents commuting costs for which the Commonwealth is not obligated to reimburse providers. Finally, the CEO admitted that his recent switch to part-time status has been accompanied by less business-related travel.

Following the audit, Scovell and Schwager's private accountant provided the following response to our concerns about the CEO's vehicle:

> As regards supportive documentation for provider's cars, Mr. Schwager (Mr. Scovell's partner) maintained log books for business travel which were reviewed by your office and were found satisfactory. Mr. Scovell will institute a similar system as part of a provider's policy to have formal log books for all auto reimbursement.

The table below details Scovell and Schwager's fiscal year 1993 vehicle expense applicable to the CEO and his spouse.

Expense	1992 Accura (CEO)	1989 Accura (Spouse)	Total
Depreciation	$1,210	$1,342	$2,552
Insurance	1,270	2,096	3,366
Excise Tax	469	56	525
Gasoline/Repairs	3,211	-	3,211
Totals	$6,160	$3,494	$9,654

o Other Non-Program Expenses Totalling $2,263: Scovell and Schwager utilized state funds totalling $2,263 for entertainment expenses and employee gifts. In doing so, the agency violated 808 CMR 1.15(12), which prohibits the Commonwealth from reimbursing providers for non-program expenses. The Commonwealth defines non-program expenses as "Expenses of the provider which are not directly related to the social service program purposes of the agency."

Following the audit, the agency's private accountants provided the following explanation for the expenditures.

> Common business practice allows a reasonable amount of employer to employee gifts on special occasions. Such occasions include the

> birth of a baby and get well gifts. They know of no regulation that expressly prohibits such actions. Regarding business entertainment and the purchase of theater tickets, once again, they believe that a legitimate business rationale exists for these expenses and are not aware of a regulation expressly forbidding them. As one of the very few for profit companies in human services, the providers have attempted to balance the legitimate activities of a business with the fact that public money is involved. They believe that the modest nature of these expenses compared to the total budget of the providers, and to those expenses of nonprofit vendors, indicates the providers has applied prudence to these expenses.

The private accountant's assertion that common business practice legitimizes the purchase of theater tickets and employee gifts by Scovell and Schwager is unfounded within the state's purchase-of-service system. The Commonwealth awarded three contracts to Scovell and Schwager for the specific purpose of serving individuals with serious mental illness. Under the terms of the contracts, the Commonwealth is obligated to fund Scovell and Schwager for costs that are directly related to the agency's program services. The Commonwealth, however, will not knowingly waste taxpayer dollars on Scovell and Schwager entertainment expenses or personal employee favors. Scovell and Schwager is obligated to use state funds solely for the benefit of its clients.

d. <u>The Center for Human and Health Services, Inc., Provided Its President with an Excessive Fringe Benefit Package that Cost the Commonwealth $35,571</u>: The Center for Human and Health Services (CHHS) provided its president with a fringe benefit package that violated state regulations. Specifically, CHHS maintained an unqualified pension plan exclusively for the president. The special plan, which supplemented the agency's regular employee pension plan, cost CHHS $30,868 during fiscal year 1993. Additionally, CHHS provided the president with a $700,000 whole life insurance policy. The insurance policy cost CHHS $4,703 and was offered exclusively to the president. In each instance, CHHS utilized state funds to pay for the president's benefits.

In purchasing a social service program, the Commonwealth will not pay for

costs which have been identified in 808 CMR 1.15(1)-(22) as nonreimbursable costs. Under Section (9) of this regulation, the Commonwealth identifies "Certain Fringe Benefits" as nonreimbursable costs and defines them as:

> Fringe benefits determined to be excessive in light of salary levels and benefits of other comparable providers and fringe benefits to the extent that they are not available to all employees under an established policy of the provider. Disparity in benefits among employees attributable to length of service, collective bargaining agreements or regular hours of employment shall not result in the exclusion of such costs.

Contrary to 808 CMR 1.15(19), CHHS utilized state monies to fund two separate pension plans during fiscal year 1993. The agency's principal pension plan is available to all qualified employees, including CHHS's president. Under this plan, CHHS contributes 3% of each participating employee's base salary into a tax-sheltered annuity. Since the plan is available to all CHHS employees and is comparable to pension plans offered by many human service providers, CHHS's cost to maintain the plan represents an allowable program cost.

However, CHHS provided its president with a supplemental pension plan that cost the agency $30,868 during fiscal year 1993. Under the supplemental plan, which is offered exclusively to the president, the agency contributes 35% of the president's salary (35% x $88,195 = $30,868) into an unqualified pension fund. The fund is maintained by CHHS, and, under the terms of the fund, the president may withdraw all contributions, at will, without penalty. Since the president is the sole recipient of this fringe benefit, the cost of the plan represents a nonreimbursable cost to the Commonwealth.

In addition to the pension benefits, CHHS also provided the president with a $700,000 whole life insurance policy. Initially, CHHS purchased for the president a $400,000 policy during 1987. The following year, CHHS supplemented it with a $300,000 policy. Under the terms of each policy, the president's spouse is the designated beneficiary. Additionally, the policies

are transportable (i.e., remain with the president) in the event that the president should terminate his employment with CHHS.

Based upon 808 CMR 1.15(19), the $4,703 annual premium for the president's life insurance represents a nonreimbursable cost to the Commonwealth because the agency does not offer whole life insurance coverage to its remaining employees. Instead, CHHS provides everyone else with group term coverage equal to three times his/her salary. Either the president should receive the same group term life insurance coverage, or the cost of his whole life policies should be funded through non-state revenues.

e. Brown and Sullivan, Inc., Violated State Regulations by Loaning Employees $10,539 in State Funds: Brown and Sullivan utilized state funds totalling $10,539 for employee loans. Since the loans were not provided for in Brown and Sullivan's program budgets and since Brown and Sullivan does not have any privately generated funds of its own to use, we consider this to be an unauthorized use of Commonwealth program funds and question the propriety of such a transaction.

DPS regulations define the cost of such a transaction to be non-reimbursable under state contracts. Specifically, 808 CMR 1.15(12) states the following shall be nonreimbursable costs:

> Non-Program Expenses: Expenses of the provider which are not directly related to the social service program purposes of the provider.

These employee loans not only violated DPS regulations, but also contributed to several administrative and fiscal problems for Brown and Sullivan. First, as of July 1, 1992 Brown and Sullivan had an unfunded liability totalling $164,000. Yet from July 1, 1992 through September 30, 1993, Brown and Sullivan approved 13 interest-free loans totalling $10,539. By awarding the loans at a time when the agency was experiencing serious fiscal problems, Brown and Sullivan officials displayed a lack of fiscal

prudence, jeopardized the survival of the agency, and failed to safeguard the Commonwealth's assets. In addition, Brown and Sullivan did not adequately document the terms and conditions of the 13 employee loans. Specifically, loan documents were not signed by an authorized agency official, and one loan totalling $247 was awarded without the benefit of any loan documentation.

On September 16, 1993, we spoke with Brown and Sullivan's fiscal officer to keep him apprised of issues identified during the audit. During the meeting, we emphasized that the agency's employee loans violated DPS regulations and that Brown and Sullivan needed to correct documentation deficiencies found with several of the loans. Although the fiscal officer agreed that the loans were not fiscally prudent, he subsequently made another employee a loan for $1,292 just one week following our meeting. When asked about the $1,292 loan, the fiscal officer offered no comment. Such actions by Brown and Sullivan's fiscal officer raises the question of whether the agency is qualified to administer state contracts in the future. The chart below details the 13 employee loans awarded by Brown and Sullivan.

Employee Name	Amount of Loan	Date of Loan	Check Number
A.	$ 800.00	10/12/92	#2291
B.	375.00	10/14/92	#2297
C.	200.00	12/02/92	#2533
D.	300.00	12/09/92	#2566
E.	2,400.00	12/21/92	#2639
F.	300.00	01/11/93	#2720
G.	1,500.00	02/01/93	#2816
H.	600.00	05/07/93	#3234
I.	247.27	04/02/93	#3159
J.	125.00	09/09/93	#3443
K.	400.00	07/26/93	#3393
L.	2,000.00	07/22/93	CASH
M.	1,292.00	09/21/93	#3465
Total	$10,539.27		

f. <u>Brown and Sullivan, Inc., Incurred Interest and Penalties Totalling $73,471 Due to the Late Payment of Payroll Taxes</u>: Brown and Sullivan failed to remit payroll taxes on time to the Massachusetts Department of Revenue (DOR), the Massachusetts Department of Employment and Training (DET), and the Internal Revenue Service (IRS). Consequently, DOR, DET, and IRS assessed the agency interest and penalties totalling $73,471 for the period July 1, 1991 through September 30, 1993. To cover these charges, Brown and Sullivan utilized state contract funds. However, according to state regulations, interest and penalties resulting from delinquent tax payments are unallowable contract costs. Specifically, 808 CMR 1.15, Section 3, classifies the following expenses as being nonreimbursable:

> Any interest or penalties incurred because of late payment of loans or other indebtedness, late filing or payment of federal and state tax returns, municipal taxes, unemployment taxes, social security, and the like are nonreimbursable expenses.

Brown and Sullivan officials stated that over the past few years cash-flow problems have prevented the agency from remitting its payroll taxes in a timely manner. Furthermore, the officials explained that a shortage of working capital has required them to choose between paying daily operating expenses (e.g., payroll, insurance, leases) or meeting their state and federal payroll tax liability. In order to remain in operation, the officials believed that they had to delay paying their payroll taxes so that the agency's daily operating expenses could be met.

However, our review indicated that Brown and Sullivan's cash-flow problems resulted, in part, from the agency's failure to utilize state funds in a fiscally prudent manner. Brown and Sullivan officials allowed state funds to be used for such non-program expenses as New Year's Eve celebrations, personal out-of-state telephone calls, employee loans, and payments to Connecticut-based programs. Furthermore, the agency employed two

Executive Directors and allowed employees to utilize agency vehicles for their personal use. We believe that Brown and Sullivan could have avoided, in part or in total, its cash-flow problems and the consequential $73,471 in interest and penalty charges had the agency utilized its state funds solely for programmatic purposes. The non-program and excessive costs noted above are further discussed throughout this report. The table below identifies Brown and Sullivan's unallowable interest and penalty charges for fiscal years 1992 and 1993, which only exacerbated its cash flow problems.

Interest and Penalties

	Internal Revenue Service	Massachusetts Department of Employment/Training	Massachusetts Department of Revenue	Totals
FY 1992	$44,812	$3,184	$1,789	$49,785
FY 1993	20,660	1,133	1,893	23,686
Subtotal	$65,472	$4,317	$3,682	$73,471

g. Life Resources, Inc., Provided Unnecessary Christmas Bonuses Totalling $5,025: During December 1992, Life Resources provided Christmas bonuses totalling $5,025 to its administrative and direct care staff. The agency utilized state funds for the bonuses, which ranged up to $800. Such bonuses represent non-program expenses, which under 808 CMR 1.15(12) are defined as "expenses of the provider which are not directly related to the social service program purposes of the provider." Additionally, under 808 CMR 1.15 such costs are classified as nonreimbursable and are subject to recoupment by the Commonwealth. The table below details the Christmas bonuses awarded by Life Resources, Inc., during fiscal year 1993.

Staff Position	Bonus Amount	Total Amount
Program Director: Montvale House	$800	$ 800
Program Directors (2): Alpha and Phaneuf Houses	125	250

Staff Position	Bonus Amount	Total Amount
Program Director:		
Ruocco House	100	100
Administrative Staff:		
Controller/Central Office	175	175
Executive Director	65	65
Program Accountant	65	65
Secretary	80	80
Direct Care Staff (2)	85	170
Direct Care Staff (2)	75	150
Direct Care Staff (43)	65	2,795
Direct Care Staff (1)	40	40
Direct Care Staff (6)	35	210
Direct Care Staff (5)	25	125
Total		$5,025

The unreasonableness of Life Resources's Christmas bonuses is underscored by the fact that the agency also provided a 5% salary bonus to its entire staff on June 30, 1993. The salary bonus totalled $61,201, which the agency funded through excess state revenues, in lieu of cost of living increases. By providing two separate employee bonuses, Life Resources failed to meet its fiscal responsibility to safeguard the Commonwealth's assets. Fiscal prudence advocates that Life Resources set aside surplus contract payments for future unexpected expenses and to further pursue the agency's mission.

h. The Key Program, Inc., Utilized State Funds Totalling $4,091 for Unnecessary College Tuition Reimbursements: During the autumn of 1992, the Director of Administration and Finance at The Key Program attended law school at Western New England College, where he was enrolled in four courses. Because the administrator successfully completed each course, The Key Program utilized state funds totalling $4,091 to reimburse his tuition expenses.

By reimbursing the administrator, The Key Program violated state regulations governing the pricing, reporting, and auditing of purchased social service programs. Specifically, 808 CMR 1.15(12) states that the Commonwealth

will not reimburse human service providers for non-program expenses, which the Commonwealth defines as "Expenses of the provider which are not directly related to the social service program purposes of the provider."

The director's pursuit of a law degree does not directly relate to the program purposes of the agency. The Key Program contracts with the Commonwealth to provide residential and nonresidential services for troubled adolescents and emotionally disturbed or mentally ill young people. Such services require the agency to employ key personnel such as clinic therapists, program supervisors, caseworkers, education instructors, and administrative support. Furthermore, the director's responsibilities at the agency, which are administrative and financial in nature, do not require him to possess a Juris Doctor (JD) degree. Consequently, the director's legal pursuits were personal in nature and should not have been financed with state funds.

In addition to violating state regulations, The Key Program violated its personnel policies and procedures regarding educational reimbursement. The Key Program's policies and procedures limit the total reimbursement available to agency personnel to two courses per term and six courses per calendar year. Also, the agency's policies and procedures limit the reimbursement to the amount of tuition and fees or $350 per course, whichever is less. Based upon the agency's personnel requirements, the director was entitled to reimbursement totalling $700 (two courses at $350 per course) rather than the $4,091 that he received.

i. <u>Eight Providers Had Inadequate Internal Controls over Their Telephone Systems, Which Resulted in Unallowable Costs Totaling $18,026</u>: Our audit revealed that eight of the 18 human service providers did not establish an adequate system of internal controls over the use of their telephone systems by members of their staff. Specifically, the providers did not maintain

adequate documentation to support the programmatic need for long-distance telephone calls. Additionally, the providers had not established procedures to identify and recover reimbursements for the personal calls made by provider staff. Most providers considered all telephone calls to be business-related, unless an employee reported otherwise. Consequently, the providers utilized state funds totalling $18,026 for interstate, overseas, and 1-900 telephone calls that were not related to the program purposes of these agencies.

Under 808 CMR 2.00, DPS has established the General Conditions of the Master Agreement (General Conditions), which is a required contract document for the purchase of a social service program. Consolidated within these General Conditions are contract provisions of general applicability to social service contracts such as contract administration, service delivery policies, personnel policies, payment, and contract audit. These General Conditions are incorporated by reference and are made a part of the Master Agreement entered into by providers of social service programs. They are applicable to all service contracts beginning on or after July 1, 1992, as well as to renewals of service contracts awarded in prior years.

Within the contract audit component of the General Conditions, DPS has required social service providers to maintain documentation to support all contract costs reimbursed by the Commonwealth. Specifically, Section VIII A.1.(a), states, in part:

> The provider shall keep on file...financial books, supporting documents, statistical records, and all other records which reflect revenues associated with and costs incurred in and allocated to any program of services rendered under the Service Contract.

Additionally, DPS has promulgated regulations that prohibit social service providers from expending state funds for non-program expenses. Specifically, 808 CMR 1.15 states that the Commonwealth will not reimburse social service providers for non-program expenses, which DPS defines as "Expenses of the

provider which are not directly related to the social service purposes of the provider."

During the statewide audit, we examined a sample of long-distance telephone charges at 17 of the human service provider agencies. Our intention was to ensure that the providers were maintaining adequate documentation to support the programmatic need for interstate and overseas telephone calls. Also, we intended to determine whether the providers had established internal controls to prevent long-distance calls or ensure restitution for personal telephone calls by provider staff.

Our audit tests of long-distance telephone charges revealed that nine of the providers maintained adequate control over the use of their telephone systems. For example, seven of these nine human service providers found it necessary, in the performance of their state-funded contracts, to place interstate telephone calls throughout the United States. For the most part, the agencies contacted state and federal agencies, human service providers and associations, and relatives of clients participating in their programs. As required by state regulations, these agencies maintained documentation that supported the programmatic need for their interstate telephone calls. They also established controls to limit personal telephone calls and to ensure employee restitution for such calls.

However, eight of the human service providers had not established and implemented policies and procedures that required members of their staff to document whether calls made on the agencies telephone system were personal or business-related. Therefore, these providers could not provide any documentation to substantiate that $18,026 in interstate, overseas, and 1-900 calls made by members of their staff during the period covered by our audit were business-related and therefore reimbursable under state contracts. Although we recognize that provider staff may need to make some long-distance

telephone calls to locations outside the Commonwealth, available evidence indicates that the majority of telephone calls made during our audit period were non-program-related, unreasonable, excessive, and nonreimbursable. The long-distance calls made by the eight providers are detailed in the table below.

Social Service Provider	Quantity of Calls	Cost of Calls	Type of Calls	Number of States/Countries Contacted
Gandara Mental Health Center, Inc.	5,823	$ 5,759	Interstate	42
	843	2,082	Overseas	11
	26	273	1-900	
Brown and Sullivan, Inc.	4,675	3,230	Interstate	35
	3	9	Overseas	3
Behavioral Health Network, Inc.	1,070	1,247	Interstate	35
	2	44	Overseas	2
	3	96	1-900	
Early Childhood Center of Greater Springfield, Inc.	486	443	Interstate	26
	18	241	1-900	
Life Resources, Inc.	245	414	Interstate	19
	2	2	Overseas	1
Haverhill/Newburyport Human Service, Inc.	*	1,881	Interstate	*
Scovell and Schwager, Inc.	*	380	Interstate	*
	*	538	Cellular	*
Association for Community Living Inc.	*	$ 1,387	Interstate	*
Total	13,196	$18,026		

*Information relative to the number of calls made by these service providers was not readily available.

j. <u>Beaverbrook Step, Inc., Awarded Salary Bonuses Totalling $43,795 in an Inequitable Manner</u>: Six of the 18 human service providers awarded salary bonuses totalling $977,089 during fiscal year 1993. The six providers utilized state funds to accommodate the bonuses and, with, the exception of Beaverbrook Step awarded the bonuses in a manner consistent with state regulations. However, Beaverbrook Step violated 808 CMR 1.15 by limiting its Christmas

bonuses to three top administrative staff. Also, the agency failed to distribute a second bonus package in a fair and equitable manner among all of its employees. Consequently, Beaverbrook Step should return to the Commonwealth the $43,795 in state funds that were used improperly for Christmas and salary bonuses.

During the audit, we discussed the nature and necessity of salary bonuses with various provider administrators. We were informed that, over the last seven years, social service contracts have been level-funded and that "bottom lines" have been assigned by state purchasing agencies regardless of actual costs or increases in costs. In addition, some state purchasing agencies have faced financial difficulties, and, as a result, cuts in providers' base contracts have been suggested, requested, and/or made. The economic realities have demanded that provider organizations remain conservative, particularly in regard to government revenues.

Given that the highest expenditure in a service provider's budget is for payroll, providers have been reluctant to raise staff rates of pay permanently unless they are confident that operational, capitalization, and developmental needs are not jeopardized. Once salary bases are raised permanently, the provider must be assured that its budget can effectively manage the increase in every succeeding year.

In balancing the reality of limited revenues with the need to adequately compensate hard-working staff, many service providers have opted to award employees with a lump-sum salary bonus. The one-time bonuses do not affect staff rates of pay and, for the most part, are disbursed near the close of the fiscal year to ensure the availability of funding. Additionally, with the exception of Beaverbrook Step, we found that service providers have calculated salary bonuses in a fair and equitable manner and have received approval for the expenditures from their Boards of Directors. For example, the Association

for Community Living's Board of Directors approved the following salary adjustments for all active regular full and part-time employees of record as of August 8, 1993.

- 0% for all employees who have worked for the association for less than six months as of 6/30/93;

- 1.5% for employees who have worked for the association for six months to one year as of 6/30/93;

- 2.5% for employees who have worked for the association for one to two consecutive years as of 6/30/93;

- 3% for employees who have worked for the association for two to three consecutive years as of 6/30/93;

- 4% for employees who have worked for the association for three to four consecutive years as of 6/30/93; and

- 4.5% for employees who have worked for the association for more than four consecutive years as of 6/30/93.

The association's board approved the salary adjustments, which totalled $90,227, retroactively for the period July 1, 1992 through June 30, 1993. Additionally, the association's board voted to rescind the increases on July 1, 1993 because it believed that the agency's fiscal year 1994 budget was inadequate to sustain them.

In contrast, Beaverbrook Step, on two separate occasions, awarded salary bonuses to employees in a manner that violated 808 CMR 1.15. First, on December 22, 1992 the agency's Executive Director, Assistant Executive Director, and Financial Manager received bonuses totalling $3,000. At the time, Beaverbrook Step did not provide its remaining staff with similar Christmas bonuses, and did not approve the one-time expenditure for its top administrative staff. Secondly, on June 11, 1993 Beaverbrook Step awarded additional employee bonuses totalling $40,795. On this occasion, the agency's entire staff participated in the bonus program; however, the bonuses were distributed in an inequitable manner. Specifically, the agency's Executive

Director and Financial Manager received $5,000 each, and the Assistant Executive Director was awarded $2,000. Yet the remaining agency staff received an average of only $457.

Under 808 CMR 1.15, Section (9), human service providers are required to provide fringe benefits, such as salary bonuses, to all employees under an established agency policy. The policy, for the most part, must preclude disparities in benefits among employees. State funds that are used contrary to this regulation are considered nonreimbursable expenses and must be refunded to the Commonwealth. Clearly, Beaverbrook Step violated this state regulation, which states, in part:

> Fringe benefits determined to be excessive in light of salary levels and benefits of other comparable providers and fringe benefits to the extent that they are not available to all employees under an established policy of the provider [are nonreimbursable costs]. Disparity in benefits among employees attributable to length of service, collective bargaining, agreements or regular hours of employment shall not result in the exclusion of such costs.

2. <u>Sixteen Providers Purchased $45,234 in Questionable Items with State Funds</u>

We found numerous instances in which human service providers paid thousands of dollars for goods and/or services that did not directly relate to their social service program purposes. Specifically, 16 of the 18 providers (89%) utilized state contract payments totalling $45,234 for items such as office parties, meals, floral arrangements, and entertainment. Such discretionary purchases represent a questionable use of state contract funds because they benefit employees of the agencies rather than clients of the Commonwealth. These questionable purchases occurred because, during the period of our review, DPS regulations relative to non-program expenses did not clearly define unallowable contract costs. Consequently, providers throughout the Commonwealth were not properly safeguarding state contract funds.

DPS promulgated 808 CMR 1.15, which states that the Commonwealth, in purchasing a social service program, will not pay for expenses that have been identified in 808 CMR 1.15(1)-(22) as nonreimbursable costs. While most of the nonreimbursable costs identified under Section 1.15 are reasonably clear (e.g., fund-raising expenses, lobbying costs), Subsection (12), Non-Program Expenses, is ambiguous and difficult to apply. Under DPS regulations, non-program expenses are defined as follows:

> Expenses of the provider which are not directly related to the social service program purposes of the provider.

The 808 CMR 1.15, Subsection (12), is intended to prohibit service providers from expending state contract payments on goods and/or services that do not directly benefit an organization's clients, programs, or daily administration. However, Subsection (12) is somewhat ambiguous in that it does not specifically define or give examples of costs that are not program-related. For example, we identified numerous instances of providers utilizing state contract funds for employee Christmas parties. Because such expenses are not directly related to the social service program purposes of providers, they should not be borne by the Commonwealth. However, provider officials have argued that employee parties are not specifically prohibited by DPS regulations and help improve employee morale. Therefore, many of the providers audited believed that such expenses were reasonable contract costs that they will continue to incur until DPS provides additional guidelines concerning non-program expenses.

Additionally, several providers stated that, because the purchases being questioned were relatively minor in relation to their yearly program budget, they could not understand our concern. However, although the financial effect at any given provider is not overly alarming, the combined effect of the 18 providers, $45,234, represents a sizable waste of taxpayer dollars. Moreover,

the Commonwealth currently contracts with approximately 1,900 human service providers, and many of these providers may also be incurring similar questionable expenses. By clarifying CMR 1.15 (12), DPS could help ensure that state funds are not used to pay for parties, entertainment, and food expenses of human service providers, which would make available significant funds for additional human services throughout the Commonwealth.

Provided below are three examples of questionable purchases made by service providers with state funds during fiscal year 1993, and a table listing all the questionable items found during the audit.

(a) On December 31, 1992, Brown and Sullivan held a New Year's Eve party at the Sheraton Springfield Monarch Place. Attending the party were 200 guests, including employees, their spouses, board members, and clients. The party cost Brown and Sullivan $5,161, and consisted of dinner, overnight accommodations for 10 guests, entertainment, and party invitation expenses.

(b) During fiscal year 1993, the Association for Community Living (ACL) spent state funds totalling $1,606 for pastries, lunches, desserts, beverages, and snacks provided to employees attending staff meetings and conferences. ACL's fiscal officer recognized that the cost of such items was a questionable contract charge and anticipated utilizing our audit report to eliminate similar contract charges in the future.

(c) During fiscal year 1993, Growthways, Inc., expended state funds totalling $619 for flowers sent to employees who had experienced a death in their immediate family. The Executive Director believed that sending flowers was an appropriate means for the organization to express its sympathy to bereaved employees. Although we agree that it is not improper for Growthways, Inc., to acknowledge special occasions such as deaths, births, etc., the organization should not expect the Commonwealth to bear the cost of such expenditures.

Table of Questionable Contract Costs

Human Service Provider	Food Beverage	Parties/ Entertainment	Flowers	Total
Vinfen Corporation	$ 2,947	$ 4,807	$1,478	$ 9,232
Gandara Mental Health Center, Inc.	2,007	3,445	369	5,821
Brown and Sullivan, Inc.	-	5,161	-	5,161
Health Care of Southeastern Massachusetts, Inc.	864	2,835	532	4,231
Bridge of Central Massachusetts, Inc.	499	3,611	34	4,144

Table of Questionable Contract Costs (Continued)

Human Service Provider	Food Beverage	Parties/ Entertainment	Flowers	Total
Association for Community Living, Inc.	1,606	1,690	391	3,687
Charles River Association for Retarded Citizens, Inc.	605	1,693	527	2,825
Behavioral Health Network, Inc.	416	1,960	-	2,376
Scovell and Schwager, Inc.	1,060	570	38	1,668
The Key Program, Inc.	1,242	-	402	1,644
Life Resources, Inc.	1,451	-	93	1,544
Growthways, Inc.	-	486	619	1,105
Worcester Area Association For Retarded Citizens, Inc.	629	-	-	629
Early Childhood Center of Greater Springfield, Inc.	-	-	594	594
Community Enterprises, Inc.	472	-	22	494
Haverhill - Newburyport Human Services, Inc.	45	-	34	79
Total	$13,843	$26,258	$5,133	$45,234

3. **Seven Providers Did Not Maintain Adequate Records and Supporting Documentation for $788,191 in Expenses Charged to State Contracts**

DPS's General Contract Conditions require service providers to maintain adequate records and supporting documentation for costs incurred in the performance of a contract. Specifically, Section VII a.(1) of these General Contract Conditions for fiscal year 1993 states:

> The provider shall keep on file. . . financial records, supporting documents, statistical records, and all other records which reflect costs incurred in and allocated to performance of the services rendered under this agreement.

We examined a sample of administrative expenditures made by the 18 human service providers to ensure that each provider maintained records and documents that adequately supported contract expenditures. We found that, during fiscal year 1993, seven providers expended state funds totalling $788,191 without adequate supporting documentation. Specifically, documentation was found to be lacking in the areas of (a) consultant services, (b) time and attendance reports for administrative staff, and (c) personal use of administrative vehicles. Each area is discussed in detail below.

a. Consultant Services: The Key Program and Scovell and Schwager did not maintain adequate documentation to support consultant charges totalling $244,944 to state contracts. The Key Program incurred consultant charges totalling $236,006 during fiscal year 1993 for legal and auditing, consulting, and training services. Although the Key Program maintained billing invoices for the consultant charges, the agency did not (1) formally advertise its required services through a Request for Proposals (RFP) process; (2) obtain competitive bids in an effort to minimize costs to the Commonwealth; (3) prepare consultant contracts detailing the scope of services, maximum financial obligation, and the terms and conditions for payment; and (4) establish a threshold contract amount that requires the Board of Directors' approval.

Because The Key Program did not maintain documentation supporting its consultant contracts, it could not ensure that charges made to its state contracts were reasonable, allowable, and allocable. In fact, we identified several instances in which the agency utilized state funds for unnecessary and unallowable consultant services. Examples of such services include consultants' (1) performing routine daily accounting functions, (2) representing the agency in out-of-state litigation matters, (3) promoting the agency's operations outside the Commonwealth, and (4) pursuing "for-profit" status for the agency.

During the audit, The Key Program's Executive Director agreed that the agency needed to establish greater administrative controls over its consultant contracts. In addition, prior to our exit conference, the Executive Director drafted an agency policy that addressed our concerns. The agency's drafted policy, "Key's Policy for Personal Service Contracts," is provided below.

- Personal Service is defined as a non-tangible service including legal, audit, consulting, and training of a value exceeding $3,000 in any one instance, or if the aggregate during a fiscal year (7/1-6/30) is likely to be in excess of $3,000.

- Each Personal Service contract should be bid according to Key's procurement policy.

- Each Personal Service's contract shall include a detailed description of work to be performed, report(s), if applicable, to be produced, the rate of reimbursement; maximum dollar to be expended under the contract; documentation of time and dates spent on the project.

- A Personal Service's contract can be amended. Any time frame for completion amendment shall include those items appearing in three above.

Similarly, Scovell and Schwager did not maintain adequate documentation to support charges totalling $8,938 (9,822 in total undocumented consultant costs x 91% state-funded) to its state contracts. Specifically, during fiscal year 1993, the agency utilized five consultants for various professional services. However, the agency did not prepare service contracts for each consultant that detailed the scope of services to be performed, the maximum financial obligation of the agency, and the terms and conditions for payment. Additionally, the agency's necessity for these services could not be substantiated because the consultants submitted billing invoices that did not detail their rendered services. Consequently, Scovell and Schwager could not ensure that professional fees charged to its state contracts were reasonable, allowable, and allocable.

During our exit conference, Scovell and Schwager officials agreed to prepare consultant contracts for all future professional services. Additionally, following the completion of our audit, the agency's private accountant confirmed his client's intentions in writing:

> You noted that some $9,822 in professional consulting costs were not backed up by contracts sufficiently detailing the scope of services provided. In our discussions with you, they agreed to adopt a form of contract that clearly identifies the scope and amount of money involved. Their policy is to avoid employing outside consultants as much as possible; when they do, you can be sure that the services are delivered and properly attributed on our books.

b. <u>Time and Attendance Reports</u>: Our audit revealed that Scovell and Schwager, Brown and Sullivan, and the Worcester Area Association for Retarded

Citizens, did not maintain adequate documentation to support personnel charges totalling $488,609 to state contracts. Specifically, these providers did not require their executive officers to maintain time and attendance reports detailing hours and days worked. Consequently, the providers cannot ensure that all personnel costs charged to state contracts were allowable, allocable, and reasonable.

DPS's General Contract Conditions requires providers to maintain personnel records for each employee. Specifically, Section VI(C)(2) states that the provider shall maintain personnel records for each employee and that these records shall include, but not be limited to:

- Statements of job description and responsibilities;
- Statements of job qualifications;
- Resumes or job applications of employees, including name, address, social security number, education and/or experience, and copies of all licenses and certifications required to perform the job; and
- Other records, including payroll and time and attendance records documenting program assignments and hours and days worked, required by and maintained in accordance with generally accepted accounting principles recommended by the American Institute of Certified Public Accountants.

Although provider officials at each location questioned the need for executive officers to maintain time and attendance reports, the daily activities of officials at Brown and Sullivan, and Scovell and Schwager underscore the need for such documentation. As noted in Audit Result No. 1b, Brown and Sullivan's Executive Director spends a significant amount of his time away from the agency teaching psychology and sociology courses at Springfield Technical Community College and Holyoke Community College. Since September 1991, the Executive Director has collected both a full salary from Brown and Sullivan and teaching fees from the colleges. The Executive Director contended that he compensated the agency for his absence by working evenings and weekends on agency matters. However, without time and attendance

reports documenting such work, Brown and Sullivan cannot assure the Commonwealth that the Executive Director's salary was a reasonable, allowable, and allocable program cost.

At Scovell and Schwager, employees involved in more than one activity must complete time and attendance reports detailing the work performed, the hours worked, and the work's functional classification. Such information is necessary for the provider to ensure the proper allocation of administrative salaries to its state and non-state contracts. However, we found that the CEO and president failed to maintain similar time and attendance reports. Furthermore, the time reports prepared by the agency's Director of Finance and Administrative Clerk did not differentiate between time spent on state contracts and non-state contracts. Without appropriate documentation, Scovell and Schwager could only estimate the time spent on state contracts by its administrative staff. Consequently, Scovell and Schwager cannot ensure that administrative salaries charged to its state contracts were reasonable, allowable, and allocable.

The chart below details the administrative salaries charged to state contracts for which Brown and Sullivan, Scovell and Schwager, and the Worcester Area Association For Retarded Citizens, failed to maintain adequate supporting documentation.

Human Service Provider	Administrative Position	Salary Amount
Scovell and Schwager, Inc.	CEO	$ 52,224
	President	105,000
	Director of Finance	74,316
	Administrative Clerk	15,805
		$247,345
Worcester Area Association For Retarded Citizens, Inc.	Executive Director	$ 76,193
	Assistant Executive Director	65,071
		$141,264

Human Service Provider	Administrative Position	Salary Amount
Brown and Sullivan, Inc.	Co-Executive Director	$ 50,000
	Co-Executive Director	50,000
		$100,000
		$488,609

c. Personal Use of Administrative Vehicles: Brown and Sullivan, Vinfen Corporation, and Scovell and Schwager failed to maintain documentation supporting fiscal year 1993 vehicle expenses totalling $54,638. Under state regulations, providers must maintain statistical records detailing the business and personal use of agency vehicles. Without such records, providers can not ensure that vehicle expenses charged to state contracts represent reasonable, allowable, and allocable program costs.

As previously noted, DPS has established General Contract Conditions that apply to all state contracts awarded to social service providers. Under these conditions, service providers are required to maintain adequate records and supporting documentation for costs incurred in the performance of a contract. Specifically, Section VII a. (1) states:

> The provider shall keep on file . . . financial records, supporting documents, and statistical records, and all other records which reflect costs incurred in and allocated to performance of the services rendered under this agreement.

Social service providers must maintain vehicle usage logs for vehicles that are not used exclusively for client transportation. For example, logs are essential documentation for vehicles assigned to administrative staff. Most often, administrators utilize their vehicles for both business and personal travel. Without a log, providers can not accurately allocate the cost of operating an administrator's vehicle to state contracts. The specific problems identified at Brown and Sullivan, Vinfen Corp., and Scovell and Schwager, are detailed below.

During fiscal year 1993, Brown and Sullivan's Co-Executive Directors were provided with a 1990 Pontiac Sunbird and a 1991 Buick Skylark. The agency charged the total cost of operating the vehicles, $9,918, to its state contracts. The operating costs consisted of lease payments totalling $6,198; insurance premiums totalling $2,303; and gasoline and repair expenses totalling $1,417.

Brown and Sullivan's Fiscal Officer stated that, although the Co-Executive Directors utilized their vehicles for business and personal travel, neither official maintained a log to differentiate between the two. Additionally, he stated that the agency did not identify and report to the IRS, by Form W2 or Form 1099, the value associated with any personal use of the vehicles.

Similarly, Vinfen Corporation provided its President, Senior Vice-President for Operations, Vice-President for Administration and Finance, and Vice-President for Mental Health Services with vehicles that were funded through state contracts. During fiscal year 1993, each official received a 1992 mid-sized automobile that cost the corporation $35,066. The cost to operate the vehicles consisted of lease payments totalling $22,270; insurance premiums totalling $10,711; and repair costs totalling $2,085.

Contrary to state regulations, Vinfen Corporation did not maintain statistical records detailing the business and personal use of agency vehicles. Vinfen Corporation responded in writing to this issue, as follows:

> I think that the question is not so much with the nature or validity of these expenses as much as it is with the fact that we did not identify and report to the IRS, by Form W2 or Form 1099, the value associated with any personal use which may have been made of these vehicles. As mentioned to you during the audit, we ask that certain staff take vehicles home at night in that the vehicles place of garage will be in a location which has a significant lower auto premium than if it were garaged at our facilities in Boston. Additionally, persons who do take a vehicle home at night are not reimbursed any monies for mileage allowance or gasoline costs associated with any use of the vehicle.

Nevertheless, the response provided by Vinfen Corporation does not mitigate our concerns in this matter. Essentially, the corporation did not provide any evidence to suggest that the administrative vehicles were used exclusively for business-related matters or client transportation. In fact, the corporation acknowledged that individuals utilized the vehicles for commuting purposes. Consequently, during fiscal year 1993, Vinfen Corporation improperly allocated the vehicles' expenses to state contracts. The Commonwealth must now take steps to recover these funds and require Vinfen Corporation to establish controls to prevent future problems of this nature.

Scovell and Schwager also failed to maintain documentation supporting the programmatic need for vehicles charged to state contracts. During fiscal year 1993, the agency provided its CEO and his spouse with a 1992 and 1989 Accura. As discussed in Audit Result No. 1c, the cost to operate and maintain the vehicles, $9,654, was improperly charged by the agency to state contracts.

4. <u>Nine Providers Incorrectly Reported $559,048 in Program Costs</u>

Nine of the 18 human service providers, due primarily to inadequate internal controls over the proper classification of direct and indirect costs, incorrectly reported program costs to DPS. Specifically, seven providers reported direct program costs totalling $298,759 as administrative expenses on their fiscal year 1993 Uniform Financial Statements and Independent Auditor's Report (UFR). Conversely, two providers reported to DPS administrative costs totalling $260,289 as direct program expenses. In doing so, the nine providers failed to provide the Commonwealth with the actual results of their fiscal year 1993 operations and hindered the Commonwealth's efforts to collect, analyze, control, and report social service costs.

DPS has developed its Component Price Catalog (CPC) to assist state agencies and state human service providers in developing contract budgets for social service programs. The catalog provides standard prices for direct

program components such as direct care staff, consultant services, staff training, and client meals. Additionally, the catalog provides users with indirect cost rates for general and administrative expenses such as administrative and support personnel, working capital interest, office supplies, legal consultants, and advertising. DPS updates the CPC periodically to reflect market price changes, improved data collection, and continuing analysis.

Under OMB Circular A-122, nonprofit organizations are provided principles for determining costs of grants, contracts, and other agreements. OMB Circular A-122 defines direct costs as those costs that can be identified specifically with a particular final cost objective. Indirect costs are defined as those costs that have been incurred for indirect or joint objectives and cannot be readily identified with a particular final cost objective without effort disproportionate to the results achieved.

Although OMB Circular A-122 clearly defines direct and indirect costs for nonprofit agencies, and DPS's CPC provides service providers a comprehensive listing of direct care and administrative support expenses, nine of the 18 human service providers failed to classify and report program expenses correctly. In some instances, the errors were caused by weaknesses in a service provider's internal control system. Additionally, a few service providers simply made unintentional mistakes when classifying program expenses. Finally, instances were found in which service providers intentionally misclassified expenses due to budgetary constraints. Detailed below are three examples of service providers reporting inaccurate information to DPS due to the misclassification of fiscal year 1993 program expenses.

During fiscal year 1993, Vinfen Corporation purchased $191,949 of professional liability insurance. Of this amount, Vinfen Corporation reported to DPS $115,502 as administrative overhead on its fiscal year 1993 UFR. The

remaining $76,447 was reported to DPS as direct program support. We found that the liability insurance provided coverage solely for Vinfen Corporation's direct care staff. As such, the total expense should have been classified and reported to DPS as direct program support. DPS's CPC defines direct program support as follows:

> This category is for direct program support which can be associated with a single program and not allocated across programs. This category does not include personnel. This category includes office supplies and materials, telephone, advertising and recruitment, postage, printing and reproduction, working capital interest, leasing or routine replacement of office equipment (including depreciation and interest) equipment maintenance, accreditation fees, and professional insurance. This category does not include resources defined as Nonreimbursable Costs by regulation, e.g., fund-raising or discriminatory benefits.

Vinfen Corporation's Executive Director stated that the increased cost of liability insurance coverage necessitated by the higher limits that the corporation requires as protection requires that a portion of these higher premiums be charged to indirect program costs. He added that this was especially true in light of the fact that contracts have not been granted cost-of-living increases since 1989, in spite of significant cost increases in many areas, including insurance coverage.

Despite the Executive Director's contention, Vinfen Corporation must report program costs as accurately as possible to DPS. Although the Commonwealth has level-funded Vinfen Corporation since 1989, program expenses must be properly classified and subsequently reported to DPS through the annual UFR process. Without accurate reporting, the Commonwealth cannot be assured that Vinfen Corporation's contract costs are allowable, reasonable, and allocable. Finally, it should be noted that Vinfen Corporation had a $570,130 surplus for fiscal year 1993. The surplus should have accommodated any increase in insurance premiums that Vinfen Corporation incurred for professional liability insurance.

Also, during fiscal year 1993, the Early Childhood Center of Greater Springfield, Inc. maintained its administrative offices and two day care programs at a common site. The center leased the site for $91,037, which it reported, in total, to DPS as a direct program expenditure. However, based upon the square footage occupied by the agency's administrative staff, we determined that the center should have reported $15,241 of the lease expense as an indirect expense on its fiscal year 1993 UFR. Additionally, the center purchased property insurance for the site that cost $4,388. Once again, the center did not report a portion of the expense to DPS as an indirect program cost. Based upon the square footage occupied by the center's administrative staff, the agency should have reported to DPS $735 of the property insurance cost as an indirect program expense.

The center's Executive Director agreed that a portion of the lease and property insurance expense should have been allocated to indirect costs on the fiscal year 1993 UFR. He further stated that the error was unintentional and an oversight on his part. Finally, he indicated that the center will take corrective action to ensure that these expenses are properly reported on all future UFRs.

Finally, we found that, during fiscal year 1993, Life Resources' Executive Director purchased various household items for the agency's residential program sites. The Executive Director utilized the agency's corporate credit card for 27 purchases totalling $4,030. The items purchased included household furniture, bedding supplies, kitchen ware, maintenance materials, office supplies, and sporting goods. Although the purchases directly benefitted the clients living at each residential site, Life Resources erroneously reported the costs to DPS as indirect program expenses.

Life Resources' Executive Director agreed that the purchases should have been reported as direct program costs on the agency's fiscal year 1993

UFR. Furthermore, he concurred that similar problems could be avoided in the future by improving Life Resources's system of internal controls. Specifically, for all future credit card purchases, the Executive Director plans to denote the appropriate expense account to be charged on the credit card receipts.

By incorrectly reporting program costs, Vinfen Corporation, the Early Childhood Center of Greater Springfield, and Life Resources failed to provide the Commonwealth with the actual results of their fiscal year 1993 operations, thereby hindering the Commonwealth's efforts to collect, analyze, utilize, and report social service costs. Detailed in the table below is a complete listing of the reporting problems identified during our statewide review.

		Incorrectly Reported as	
Human Service Provider	Expense Item	Direct Expense	Indirect Expense
Gandara Mental Health Center	Utilities	$ 62,896	
	Office	44,148	
	Insurance	34,929	
	Telephone	28,158	
	Dues and Subscriptions	12,966	
	Depreciation	12,647	
	Postage & Printing	10,538	
	Advertising	10,507	
	Equipment Rent/ Maintenance	9,207	
	Miscellaneous	6,507	
	Security	4,380	
	Building Custodian	3,289	
	Building Maintenance	3,096	
	Rent	2,916	
	Fees and Permits	638	
	Other Services	(2,509)	
Subtotal		$244,313	
Vinfen Corporation	Professional Liability Insurance		$115,502
	Alarm System		4,273
	Client Food		350
	Mortgage		162
Subtotal			$120,287

Human Service Provider	Expense Item	Incorrectly Reported as Direct Expense	Incorrectly Reported as Indirect Expense
Worcester Area Association For Retarded Citizens	Building Maintenance		$101,367
	Client Training		1,732
	Residential Program		210
	Open House		-
Subtotal			$103,309
Health Care of South-Eastern Massachusetts	Malpractice Insurance		$ 64,755
	Health Insurance		3,728
	Flowers		53
Subtotal			$ 68,536
Early Childhood Center	Office Space	$ 15,241	
	Property Insurance	735	
Subtotal		$ 15,976	
Life Resources, Inc.	Building Maintenance		$ 4,030
	Client Travel		1,513
Subtotal			$ 5,543
Beaverbrook Step, Inc.	Client Gifts		$ 500
Subtotal			$ 500
Growthways, Inc.	Client Food		$ 343
Subtotal			$ 343
Charles River Assoc. for Retarded Citizens	Building Maintenance		$ 150
	Bank Fee		91
Subtotal			$ 241
Grand Totals		$260,289	$298,759

5. **Five Providers Had Not Developed an Allowable Cost Allocation Plan**

Five of the 18 human service providers had not established an allowable plan for allocating their indirect/common costs (i.e., costs that benefit more than one function) to state contracts. Under DPS guidelines, human service providers are required to allocate indirect costs on a usage/benefit basis. However, during fiscal year 1993, Vinfen Corporation, Gandara Mental Health Center (GMHC), and Beaverbrook Step allocated $3,934,438 in indirect costs based upon available contract revenues. This allocation method is

specifically prohibited by DPS. Additionally, Haverhill/Newburyport Human Services (HNHS) utilized an obsolete plan to allocate $298,908 of its administrative salaries and occupancy costs to state contracts. Finally, Scovell and Schwager allocated $287,401 of administrative salaries between state contracts and non-program activities without the benefit of a cost allocation plan. Consequently, the five providers cannot assured that the indirect expenses charged to their state contracts were reasonable, allowable, and allocable.

Under 808 CMR 1.00, DPS has established regulations concerning pricing, reporting, and auditing of social service programs purchased by the Commonwealth. Furthermore, under Section 1.02, DPS defines "Costs Which Pertain to Various Functions" as follows:

> Many costs apply to more than one functional purpose. In such cases,it may be necessary to allocate these costs among functions because their degree of usage cannot be readily and specifically identified with each function. Examples include salaries of staff who perform more than one type of service, rental of a building used for various program services, administration and support, and fund-raising activities. Where expenses pertain to more than one function, they should be allocated to the separate functional categories based upon procedures that determine, as accurately as possible, the portion of the cost related to each function.

Additionally, DPS's Uniform Financial Statements and Independent Auditor's Report (UFR) Audit and Preparation Manual provides nonprofit organizations with the following restrictive guidance concerning the development of cost allocation plans.

> Methods for charging or allocating expenditures for the purpose of reporting expenses on the UFR that utilize budgeted or received revenues, budgeted costs, anticipated or received contract reimbursements, rather than resource usage bases, are not acceptable or in accordance with Generally Accepted Accounting Principles (GAAP).

DPS also provides guidance to contracted service providers in developing and implementing their cost allocation plan, such as OMB Circular A-122. OMB Circular A-122 also requires nonprofit organizations to develop cost

allocation plans for distributing indirect costs. Under OMB's regulations, nonprofit organizations must maintain formal accounting records that substantiate costs included in an allocation plan and the propriety of eventual charges. Furthermore, OMB requires nonprofit organizations to develop allocation plans that contain, at a minimum, (1) the nature and extent of services provided and their relevance to the contracted program, (2) the item of expense to be included, and (3) the method to be used in distributing costs. Consistent with DPS guidelines, OMB requires nonprofit organizations to utilize a service/benefit basis for allocating indirect costs.

However, contrary to these state and federal guidelines, GMHC, Vinfen Corporation, Beaverbrook Step, Scovell and Schwager, and HNHS had not developed and maintained plans that allocate costs to state contracts on a usage/benefit basis. Detailed below are the specific weaknesses we identified within each of the providers cost allocation systems.

a. <u>Gandara Mental Health Center, Inc.</u>: GMHC had not developed a formal written plan that utilizes cost benefit analysis for allocating indirect costs to state contracts. Instead, GMHC allocated $811,913 of such costs based upon the availability of state contract revenues. For example, the Department of Mental Health (DMH) during fiscal year 1992 awarded GMHC a $135,629 cost reimbursement contract to operate an aftercare program for individuals with serious long-term illness. Under the contract budget, DMH allocated GMHC a maximum of $24,562 for indirect costs. At the close of the fiscal year, GMHC's indirect cost allocation to the aftercare program should have been based upon the level of benefit that the program received from the agency's total indirect costs for the year. However, GMHC simply allocated the maximum amount allowed by DMH, $24,562, to the program.

b. <u>Vinfen Corporation</u>: Although it incurred indirect costs totalling $2,950,243 during fiscal year 1993, contrary to DPS guidelines Vinfen

Corporation did not develop a plan to allocate these costs to state contracts on a usage/benefit basis. Rather, Vinfen Corporation utilized plans that were based upon contract revenues. Detailed below are Vinfen Corporation's cost allocation plans for state cost reimbursement and unit rate contracts.

- Unit Rate Programs: The administrative overhead charge to each program is based on the fixed percentage obtained by dividing the allowable indirect dollars by the maximum contract dollar obligation (including indirect costs). This percentage is applied to the amount billed to the state to derive the administrative overhead charge by program.

- Cost Reimbursement Programs: The administrative overhead charged to each program is based on the allowable annual indirect dollars divided by the total direct program cost. The factor is multiplied against the monthly total program expense to arrive at a monthly cost reimbursement overhead figure, which is added to the other direct program costs.

Vinfen Corporation's Executive Director acknowledged that the corporation's cost allocation plans do not comply with DPS guidelines. However, the Executive Director stated that corporate officials have had many discussions on this issue with representatives of various state agencies, including DPS, and that he believed there was no consensus as to the best method for allocating indirect costs.

c. Beaverbrook Step, Inc.: Although it incurred indirect costs totalling $172,282 during fiscal year 1993, contrary to DPS guidelines Beaverbrook Step did not develop a plan to allocate these costs to state contracts on a usage/benefit basis. Rather, Beaverbrook Step, utilized plans that were based upon earned government contract revenues.

Beaverbrook Step's Executive Director stated that this methodology had been used consistently and historically and that the use of earned government revenues did not portray a skewed or unreasonable picture of the organization's finances. However, the Executive Director agreed that Beaverbrook Step committed a technical violation of the regulations as interpreted in DPS's UFR Audit and Preparation Manual. Furthermore, the

Executive Director stated that Beaverbrook Step will no longer use earned revenue but will use accrued program expenses as a basis for allocating indirect costs to state contracts.

d. Scovell and Schwager, Inc.: Scovell and Schwager allocated a portion of its fiscal year 1993 administrative salaries, $287,401, between state and non-state contracts without the benefit of time studies or cost-benefit analysis. This amount represents the salaries of Scovell and Schwager's Chief Executive Officer ($65,280), President ($132,000), Director of Finance ($74,316), and Administrative Clerk ($15,805).

In order for Scovell and Schwager to ensure the proper allocation of administrative salaries to its state and non-state contracts, individuals who are involved in more than one activity must complete time reports detailing the work performed, the hours worked, and the work's functional classification. However, we found that the Chief Executive Officer and President maintained no time reports and that the time reports prepared by the Director of Finance and Administrative Clerk did not differentiate between the time spent on state contracts and non-state contracts. Without time reports, Scovell and Schwager could only estimate the time spent on state contracts by its administrative staff. Consequently, Scovell and Schwager cannot ensure that administrative salaries charged to state contracts were reasonable, allowable, and allocable.

e. Haverhill/Newburyport Human Services, Inc. (HNHS): HNHS allocated administrative salaries totalling $252,482 to its state contracts based upon an obsolete cost allocation plan. During fiscal year 1993, HNHS needed to reduce its administrative staff significantly due to cash-flow problems. After eliminating three staff positions, however, HNHS did not adjust its cost allocation plan, which utilizes staffing levels as the basis for allocating

administrative salaries to state contracts. Consequently, HNHS cannot ensure that the administrative salaries allocated to the fiscal year 1993 state contracts were reasonable, allowable, and allocable.

Similarly, HNHS used obsolete information to allocate $46,426 of occupancy costs to its fiscal year 1993 state contracts. During the fiscal year, HNHS reduced its administrative office space following the reduction of its administrative staff. The available space was subsequently utilized by HNHS's direct care staff. However, following the change, HNHS did not adjust its cost allocation plan, which utilizes a square footage basis for allocating occupancy costs to state contracts. Consequently, HNHS cannot ensure that the administrative occupancy expense allocated to its fiscal year 1993 state contracts was reasonable, allowable, and allocable.

CONCLUSIONS AND RECOMMENDATIONS

The results of our review indicate that significant problems relative to the expenditure, classification, and reporting of indirect costs existed at the 18 human service providers we audited. As noted throughout our report, these problems were caused by a variety of factors, including the service providers' (1) inadequate systems of internal controls over their operations, (2) lack of sound business judgment, and (3) lack of awareness that certain indirect expenses they incurred were unallowable and nonreimbursable under state regulations.

Additionally, neither DPS nor state purchasing agencies have established and implemented effective fiscal monitoring policies and procedures over contracted human service providers to ensure that all indirect costs incurred by providers are reasonable, allowable, and allocable to state contracts. In addition, our audit of 40 social service providers and five state agencies found that DPS and state purchasing agencies have not developed and implemented effective fiscal monitoring procedures over contracted service providers. This report notes that, although, according to DPS officials, the UFR is the primary vehicle used by the state to provide adequate oversight of provider agencies, DPS does not have the resources (e.g., staff) to perform routine analytical reviews of the vast majority of the approximately 900 complete UFRs it receives annually. This report also notes that state agencies utilize UFR information solely to prequalify human service providers for possible state contract awards.

As a result of audits completed by the OSA, DPS has taken some measures to address our concerns relative to the allowability of human service provides costs. Specifically, in August 1993, DPS issued a summary sheet (DPS A035-93 Rev.), which further defined reimbursable and nonreimbursable costs. In this publication, DPS provides its interpretation of what types of costs would be

considered nonreimbursable in accordance with their regulations. Also, during fiscal year 1993 DPS amended its regulations to include the following as a nonreimbursable cost:

> Unallowable Costs under OMB Circular A-122 and A-21: Costs which are not allowable under OMB Circular A-122 and A-21 are non-reimbursable to programs which receive Federal financial assistance.

Finally, as a result of our audit work, DPS amended its regulations effective July 1, 1994 (fiscal year 1995) to include the following as a nonreimbursable costs.

(23) Luxury Items. All costs associated with luxury items, including, but not limited to, luxury passenger automobiles as defined in sections 4001 or 4002 of the Internal Revenue Code, airplanes, boats, vacation homes, alcoholic beverages, charitable contributions and donations, and all non-program entertainment expenses.

(24) Salaries of Officers and Managers. Salaries of officers and managers to the extent they exceed the rate paid to state managers in job group M-XII, step seven in the schedule contained in MGL c.30, s.46C. For example, if the maximum salary level in the state's management schedule is $80,000 and a provider's chief executive officer earns $100,000 and spends 25% of her time on a social service program under 808 CMR 1.00, reimbursement would be limited to $20,000 ($80,000 maximum rate x 25% = $20,000).

(25) Mortgage Principal. Mortgage principal on an amortized or other basis: no purchasing agency shall reimburse a provider for the principal portion of any note secured by a mortgage on property owned directly or indirectly by the provider.

(26) Undocumented Expenses. Costs which are not adequately documented in light of the American Institute of Certified Public Accountant's statements on auditing standards for evidential matters.

(27) Administration and Support Costs. Costs which are otherwise nonreimbursable under the provisions of 808 CMR 1.15 may not be reimbursed through administration and support.

Although DPS has taken measures to clarify to service providers what costs are nonreimbursable under state contracts, additional measures are necessary to ensure that indirect expenses being charged against state contracts are appropriate, reasonable, and properly classified and reported, as follows:

1. DPS should implement the recommendations noted in OSA Audit Report No. 93-4001-3 relative to improving the state's monitoring of contracted service providers.

2. DPS should develop an internal control guide for service providers. In conjunction, DPS should amend its regulations to require service providers to utilize the guide to develop and implement an adequate internal control structure. DPS should also require providers to submit standard documentation with their UFR each year that details their system for safeguarding the Commonwealth's assets. Such control systems should help to eliminate the types of problems we identified throughout this report.

3. State purchasing agencies, in conjunction with DPS and other interested parties, should identify business administration training opportunities and provide this information to contracted service providers. DPS, in conjunction with state purchasing agencies, should also provide regular training sessions on various pertinent business administration topics to provider staff.

4. DPS should take measures to recover the $454,104 in unallowable expenditures that we identified at the 18 human service providers. Additionally, DPS should determine whether the 18 providers need to return any additional amounts due to prior years unallowable expenses.

5. GMHC; Vinfen Corporation; Beaverbrook Step; Scovell and Schwager; and HNHS should develop and utilize a cost allocation plan in accordance with GAAP to ensure that all programs, not only state-funded programs, receive their fair and equitable share of all costs associated with providing a particular service.

6. The nine providers that incorrectly reported $559,048 in program costs to DPS should establish and implement policies and procedures that ensure that their fiscal offices utilize OMB's cost principles when reporting program expenses to DPS. Also, each provider should amend its fiscal year 1993 UFR to reflect actual program costs for the period. Copies of the amended return should be submitted to appropriate state agencies.

As a result of the conditions noted here and in Audit Report No. 93-4001-3, the Office of State Auditor is making recommendations for the reform of the Commonwealth's purchase-of-service system for its social and human service programs.

Appendix

Fiscal Year 1993 Funding Sources
For the Eighteen Human Service Providers Audited

Human Service Provider	Department of Mental Retardation	Department of Mental Health	Department of Social Services	Department of Public Welfare	Department of Public Health	Department of Youth Services
Association for Community Living, Inc.	$ 3,873,537	-	$ 104,797	$1,911,931	-	-
Community Enterprises, Inc.	461,677	$ 2,351,132	-	-	-	-
Behavioral Health Network, Inc.	201,903	3,663,200	40,102	-	$ 37,667	-
Beaverbrook Step, Inc.	1,565,750	-	-	-	-	-
Center for Health and Human Services, Inc.	-	-	-	6,008,387	-	-
Vinfen Corporation	9,969,100	17,019,480	-	-	2,062,977	-
Brown and Sullivan, Inc.	2,312,788	429,249	-	-	-	-
Gandara Mental Health Center, Inc.	33,756	993,865	547,036	-	761,342	-
Early Childhood Center of Greater Springfield, Inc.	-	-	1,373,475	38,892	-	-
Worcester Area Association for Retarded Citizens, Inc.	7,297,956	-	74,285	-	-	-
Bridge of Central Massachusetts, Inc.	942,381	2,151,513	927,982	-	-	-
Haverhill - Newburyport Human Services, Inc.	1,947,537	382,252	-	-	-	-
Charles River Association for Retarded Citizens, Inc.	1,728,150	-	-	-	-	-
Growthways, Inc.	1,466,401	-	-	-	-	-
Health Care of Southeastern Massachusetts, Inc.	-	-	372,725	-	1,333,027	$ 92,308
The Key Program, Inc.	-	722,773	5,361,184	-	-	3,237,676
Life Resources, Inc.	-	348,845	510,561	-	-	912,387
Scovell and Schwager, Inc.	-	3,037,857	-	-	9,750	-
Total	$31,800,936	$31,100,166	$9,312,147	$7,959,210	$4,204,763	$4,242,371

Appendix (Continued)

Fiscal Year 1993 Funding Sources
For the Eighteen Human Service Providers Audited

Human Service Provider	Massachusetts Commission For The Blind	Massachusetts Rehabilitation Commission	Commercial Products and Services	Out-of-State Revenue	EOHS Cash Grants	Miscellaneous	Total
Association for Community Living, Inc.	-	-	-	-	-	$ 259,417	$ 6,149,682
Community Enterprises, Inc.	$ 9,378	$ 363,907	$1,139,702	$ 819,841	-	195,232	5,340,869
Behavioral Health Network, Inc.	-	-	-	-	-	2,319,057	6,261,929
Beaverbrook Step, Inc.	-	-	-	-	-	391,491	1,957,241
Center for Health and Human Services, Inc.	-	-	-	-	$7,249,048	3,387,104	16,644,539
Vinfen Corporation	-	-	37,818	-	-	4,514,677	33,604,052
Brown and Sullivan, Inc.	77,388	829,267	-	-	-	570,125	4,218,817
Gandara Mental Health Center, Inc.	-	-	-	-	-	1,680,354	4,016,353
Early Childhood Center of Greater Springfield, Inc.	-	-	-	-	-	352,985	1,765,352
Worcester Area Association for Retarded Citizens, Inc.	-	570,604	614,916	-	-	3,397,528	11,955,289
Bridge of Central Massachusetts, Inc.	-	-	-	-	-	348,139	4,370,015
Haverhill - Newburyport Human Services, Inc.	-	-	-	-	-	1,182,074	3,511,863
Charles River Association for Retarded Citizens, Inc.	-	115,250	855,460	-	-	1,251,512	3,950,372
Growthways, Inc.	-	-	-	-	-	153,497	1,619,898
Health Care of Southeastern Massachusetts, Inc.	-	-	-	-	-	1,897,704	3,695,764
The Key Program, Inc.	-	-	-	1,923,979	-	937,239	12,182,851
Life Resources, Inc.	-	-	-	-	-	904,217	2,676,010
Scovell and Schwager, Inc.	-	-	-	-	-	409,136	3,456,743
Total	$ 86,766	$ 1,879,028	$2,647,896	$2,743,820	$7,249,048	$24,151,488	$127,377,639